ONTARIO

LEGISLATIVE ASSEMBLY

1969

REPORT

ON

CREDIT UNIONS

BY

SELECT COMMITTEE

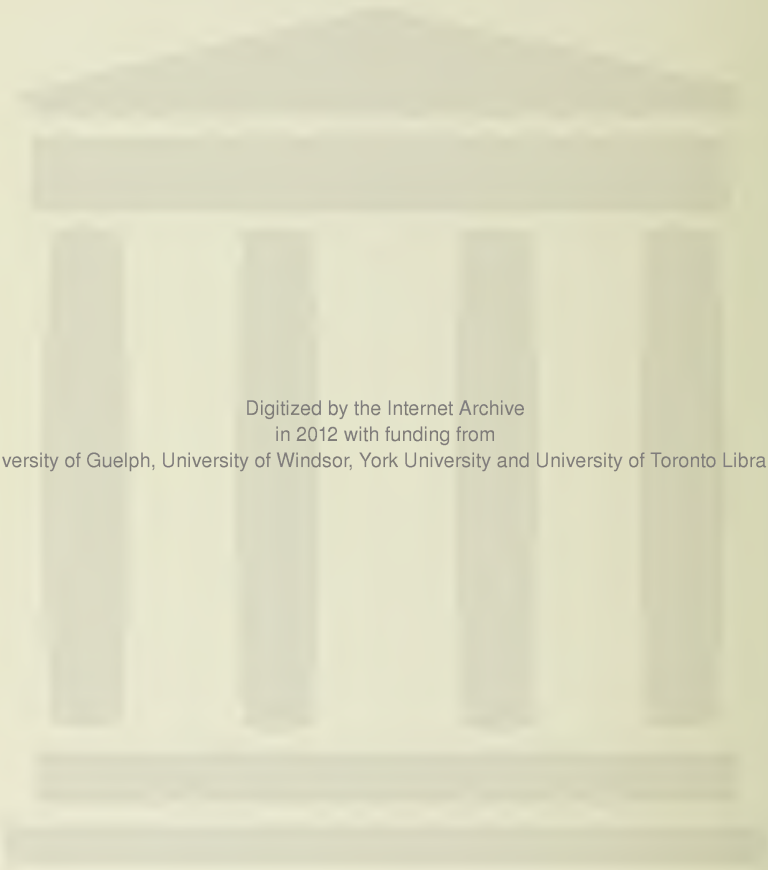
ON

COMPANY LAW

TABLED IN THE LEGISLATIVE ASSEMBLY BY

GORDON R. CARTON, Q.C., M.P.P.
CHAIRMAN

2nd SESSION, 28th LEGISLATURE, 18 ELIZABETH II



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PROVINCE OF ONTARIO
LEGISLATIVE ASSEMBLY
SELECT COMMITTEE ON COMPANY LAW
REPORT
ON
CREDIT UNIONS

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TERMS OF REFERENCE

On Tuesday, July 23, 1968 in the Legislative Assembly of Ontario, the Honourable Mr. John P. Robarts (The Prime Minister) moved, and the Honourable C. S. MacNaughton (The Provincial Treasurer) seconded, a resolution, which read in part as follows:

"That a select committee of this House be appointed to continue the enquiry and review of the law affecting the corporations in this province as reported on by the select committee of this House appointed on June 22, 1965, and re-appointed on July 8, 1966, and in particular, to enquire into and review the law relating to mergers or amalgamations, the rights of dissenting shareholders in the event of various fundamental corporate changes, the purpose, function and scope of the annual return, the field of corporation finance, the law relating to the protection of the creditor, and the dissolution of the ordinary commercial corporation in Ontario.

And further, to enquire into and report upon such specialized types of corporations as insurance companies, loan and trust companies, corporations without share capital, credit unions, finance and acceptance companies, co-operatives, and extra-provincial companies, together with the legislation of other jurisdictions relating to the same matters . . .

And the said committee to consist of 13 members to be composed as follows:

Mr. Carton (Chairman), Messrs. Braithwaite, De Monte, Henderson, Johnston (St. Catharines), Lawrence (Carleton East), Meen, Price, Reilly, Renwick (Riverdale), Rowe, Shulman and Sopha.

Motion agreed to."

On June 26, 1969, by order of the House, Mr. Trotter was substituted for Mr. Sopha in the membership of the Committee.

TO: The Honourable F. M. Cass, Q.C.,
Speaker of the Legislative Assembly of the Province of Ontario:

Sir:

We, the undersigned members of the Committee appointed by the Legislative Assembly of the Province of Ontario on July 23, 1968 to enquire into and review, inter alia, the law relating to credit unions, together with legislation of other provinces relating thereto, have now the honour to submit the attached Report on credit unions.

Gordon R. Carton, Q.C., Chairman

Leonard A. Braithwaite

Dante M. DeMonte, Q.C.

Lorne C. Henderson

Robert M. Johnston

The Hon. A.B.R. Lawrence, Q.C.

Arthur K. Meen, Q.C.

H.H. Price

Leonard M. Reilly

James Renwick, Q.C.

Russell D. Rowe

Dr. Morton Shulman

Elmer W. Sopha, Q.C.

James B. Trotter, Q.C.

INTRODUCTION

The Committee was reconstituted on July 23, 1968 with revised terms of reference, which appear above, covering a range of specialized corporations and certain aspects of the business corporation not reported on in the first Interim Report of the Select Committee.

In view of the breadth of the terms of reference and in particular the time involved in reviewing the law relating to the number and variety of specialized corporations included for consideration by this Committee, it was decided from the outset to examine and report upon each major topic separately.

The first such topic selected for consideration by the Committee was the law relating to credit unions, which so far as can be established has not been the subject of a study by a Select Committee of the Legislature since the inception of the credit union movement.

Submissions were invited from interested persons and a list of those received by the Committee appears at the end of this Report. Between January 28, 1969 and December 4, 1969, 19 meetings of the Committee were held. The Committee concluded that matters relating to the possible taxation of credit unions were outside its terms of reference and the deliberations and recommendations of this Committee were therefore made without reference to or discussion of the possibility or desirability of the incidence of taxation upon credit unions as would appear to be contemplated in the recent White Paper on Taxation. Although the recommendations in this Report are intended to be final recommendations, the Committee was compelled for reasons of time to limit its study to those areas of major concern respecting credit unions and consequently, there are certain aspects of the law regulating credit unions which are not dealt with in this Report.

Should the recommendations of this Committee contained herein be accepted and implemented, the Committee envisages a radical reconstruction and consolidation of the credit union movement in Ontario which will likely raise new questions concerning the organization and administration of credit unions. Rather than speculate as to what changes might be necessary or desirable in the future, the Committee has confined its recommendations to the present structure of the credit union movement and to facilitating its controlled expansion and consolidation which the Committee considers basic to the continued prosperity of credit unions. In the view of this Committee, it is desirable that should the recommendations

contained herein be implemented a further study of the credit union movement be conducted at some future date after the period of transition presently anticipated in order to consider further what proposals and adjustments in the law are desirable in order to preserve credit union traditions of member democracy and participation in credit unions with large memberships spread over wide areas and served by branch offices.

As specifically provided for in its terms of reference, the Committee's study of credit unions included an examination of the relevant legislation of other provinces. Meetings were held with provincial authorities and representatives of the credit union movement in Manitoba, Saskatchewan and British Columbia and the Committee wishes to record its gratitude for the assistance of those who were kind enough to meet with the Committee and also to the provincial authorities and representatives of the credit union movements of the other provinces from whom valuable information was obtained by correspondence.

The Committee also wishes to express its gratitude to Dr. B. N. Arnason, formerly Deputy Minister of Co-operation and Co-operative Development, Saskatchewan, presently advising the government of Zambia on the establishment of co-operatives in that country, to M. G. Marotte, Secretary-Treasurer of La Caisse Populaire Ste-Clair de Montréal and to M. Rosario Tremblay, Officer of Public Relations, La Fédération de Québec des Unions Régionales des Caisses Populaires Desjardins, for giving the Committee the benefit of their long experience with credit unions and caisses populaires respectively.

Representatives of the Committee also met with a number of other persons connected with government and the credit union movement in Ontario and the members of the Committee wish to express their appreciation particularly to Mr. W. M. Jaffray, Director of the Registration and Examination Branch of the Department of Financial and Commercial Affairs, Ontario, and to Mr. L. K. James, Supervisor of Credit Unions, Ontario, for their advice and continuous assistance to the Committee. In the almost total absence of analytical written material relating to credit unions their assistance was invaluable. A position paper prepared for the Committee by Professor C. H. McNairn of the University of Toronto, Faculty of Law, also greatly assisted the staff of this Committee in its research into credit unions.

The Committee was fortunate to receive the benefit of the advice of Mr. John G. Arthur, F.C.A. of Peat, Marwick, Mitchell and Company in its consideration of the guarantee fund provisions. Mr. Arthur also reviewed for the Committee Chapter 23 of the Report.

Although this Committee is indebted to a great number of persons and organizations, only some of whom are noted above, this Report would not

have been possible had it not been for the ability, experience and determined purpose of our Counsel, Mr. John W. Blain, Q.C. of the Toronto firm of McCarthy and McCarthy. Mr. Blain and our Research Director Mr. Saul Schwartz, were appointed to the Committee at the first meeting and have continued in these offices to date. Both have worked unceasingly in the preparation of this Report.

The members of the Committee and the staff wish to express their appreciation to Mrs. Frances I. Nokes who so ably, over the whole of the period of the Committee's existence, has performed our innumerable secretarial duties and the management of the Committee's office.

In the Report, for the purposes of ease of reference, the Ontario Credit Unions Act is referred to as "the Act" and provincial legislation of other provinces governing credit unions is cited by reference only to the particular province and not by way of full citation. The full citations of the relevant legislation appear below.

ONTARIO

The Credit Unions Act, R.S.O. 1960, c. 79 as amended, 1960-61, c. 16; 1964, c. 64; 1966, c. 33; 1968-69, Bill 85, The Credit Unions Amendment Act, 1968-69, assented to May 7th, 1969; Bill 199, The Credit Unions Amendment Act, 1968-69 (No. 2), assented to October 31st, 1969.

ALBERTA

The Credit Union Act, R.S.A. 1955, c. 67; as amended, 1957, c. 13; 1958, c. 13; 1959, c. 13; 1961, c. 19; 1965, c. 19; 1966, c. 23; 1968, c. 16.

BRITISH COLUMBIA

Credit Unions Act, 1961, S.B.C. 1961, c. 14; as amended, 1963, c. 12; 1964, c. 15; 1965, c. 8; 1967, c. 49; 1968, c. 13; 1969, c. 6.

MANITOBA

The Credit Unions Act, R.S.M. 1954, c. 54; as amended, 1955, c. 12; 1956, c. 11; 1957, c. 12; 1961 (First Session), c. 10; 1964 (First Session), c. 12; 1966, c. 14; 1966-67, c. 59; 1968, c. 15.

NEW BRUNSWICK

Credit Unions Act, S.N.B. 1963 (Second Session), c. 2; as amended, 1964, c. 24; 1966, c. 45; 1967, c. 32; 1968, c. 23; 1969, c. 28.

NEWFOUNDLAND

The Co-operative Societies Act, R.S.N. 1952 c. 172; as amended, 1954, c. 42; 1963, c. 4; 1966, c. 23; 1966-67, c. 79.

Nova Scotia

Credit Union Act, R.S.N.S. 1967, c. 69; as amended, 1969, c. 36.

Prince Edward Island

The Credit Union Act, S.P.E.I. 1964, c. 7; as amended, 1968, c. 16.

Quebec

Savings and Credit Unions Act, R.S.Q. 1964, c. 293; as amended, 1967, c. 72; 1968, c. 76.

Saskatchewan

The Credit Union Act, R.S.S. 1965, c. 248; as amended, 1966, c. 29; 1967, c. 51; 1968, c. 15; 1969, c. 12.

CHAPTER I

The Nature and History of the Credit Union

1. Stated in its simplest terms, a credit union is a co-operative savings and loan institution organized on a local basis among a group of people for the encouragement of thrift and to provide for its members a ready source of credit at reasonable rates of interest. As a co-operative dealing exclusively in money, a credit union may only accept funds from and make loans to its members but, unlike other co-operative ventures which follow the general co-operative principle of open membership, membership in a credit union in Ontario is limited "to persons having a common bond of occupation or association or to persons within a well-defined neighbourhood or community".[1] Members must be shareholders but shares in a credit union resemble more closely those in a co-operative rather than in a business corporation since each member has only one vote regardless of the number of shares held and credit union shares are withdrawable. Although under its by-laws a credit union may impose a notice provision before shares are withdrawn, this requirement is not generally enforced and for all practical purposes shares are withdrawable on demand. Loans may be made to members at a maximum interest rate of 1% per month[2] for "provident and productive purposes"[3] which has proved to be an elastic qualification. Credit unions can and do borrow from outside sources.

2. The origins of the modern credit union movement in Canada can be traced to the people's bank movement in Europe during the nineteenth century which fostered the growth of local co-operative credit societies in many countries.

3. The first co-operative credit society in Canada was a caisse populaire, established at Levis, Quebec in 1900 by Alphonse Desjardins. In creating the Quebec caisse populaire, Desjardins used as his model the variety of local co-operative credit societies which had been established with varying degrees of success in several European countries, but also added several features which have become basic characteristics of both the caisse populaire and the credit union in Canada and the United States. The Quebec caisse populaire was in essence a savings institution and thrift, savings and restraint upon credit were emphasized to a greater degree than in the typical European people's bank which was primarily a lending institution. Apart from philosophical beliefs, a practical reason for encouraging members to save rather than borrow was the introduction by Desjardins of the principle of limited liability which made it more difficult to raise funds from outside the membership so that in the early caisse populaire, at least, the funds available for lending depended almost entirely upon the savings of the members. Desjardins also introduced a tripartite management structure with powers of administration divided among a board of direc-

tors, a credit committee and a supervisory committee which were separately elected and constituted independent and autonomous bodies with separate and distinct functions.

4. Desjardins was also influential in the early development of credit unions in the United States and assisted in obtaining credit union legislation in Massachusetts in 1909 and in New York in 1912. But the establishment of the credit union movement in the United States essentially took place in the 1920's under the promotional leadership of Edward I. Filene and Roy F. Bergengren during which time the United States credit union evolved and has remained as a different institution from the caisse populaire of Quebec. The typical United States credit union retained the basic framework of the Desjardins caisse populaire but the credit union movement was predominantly urban and not rural as in Quebec. Members were usually linked by a social or occupational common bond, invented as an alternative to the geographical boundaries of the parish which limited the membership of a caisse populaire, in order to meet different social and economic conditions prevailing in the United States. Although the aims of the Quebec caisse populaire and the United States credit union were identical in that both sought as co-operative institutions to promote thrift and savings and to provide for the credit needs of members at reasonable rates of interest, the Quebec caisse populaire emphasized the savings aspect, whereas the United States credit union focussed more on the provision of credit. In both the caisse populaire and the credit union, loans were made only for "provident and productive purposes". According to the original policies of the caisse populaire, this completely excluded consumer loans but, as the United States credit union movement attached a broader interpretation, credit unions concentrated on providing personal consumer credit.

5. While the Quebec caisse populaire was being modified to meet the different social and economic conditions in the United States, a separate but parallel development took place in the Maritimes in the establishment of the Antigonish credit union movement. In 1928, the university at Antigonish instituted a programme of co-operative education conducted in small communities through study groups organized by the university. The establishment of co-operatives was viewed as a means of increasing the prosperity of the people in that area and since credit unions are in essence co-operative savings and loan institutions, their establishment was also encouraged as part of the general promotion of co-operative organizations. The Antigonish movement combined the framework and some of the traditions of the Quebec caisse populaire with some of the modifications made by the United States credit union movement. The credit union movement in the Maritimes, which took place around 1933, was predominantly rural and organized in small fishing and farming communities. Although they were principally "savings" societies, their lending policies were more

flexible than those of the caisse populaire. Loans for provident and productive purposes included business loans and loans to co-operatives as well as loans to individuals. Because the Antigonish credit union was developed as part of a programme to promote co-operatives, the membership bond requirement, which included the common bond version developed in the United States, was more closely related to the basic co-operative precept of open membership based on similarity of needs rather than to the small localized membership of the typical Quebec caisse populaire. This early liberal interpretation of the membership bond probably had long term effects in the administrative attitudes towards community credit unions in the Maritimes.

6. The Antigonish credit union movement spread to the western provinces in 1937-38 where credit unions were established in both rural and urban areas with both a geographical residential bond or the United States common bond of occupation or association. Although a number of credit unions were formed with an associational bond these were often in substance community credit unions where the common bond of association was membership in a local co-operative society serving the community.

7. In Ontario, prior to 1940, there were only about fifteen co-operative credit societies, mainly caisses populaires established in parishes in French speaking communities around Ottawa, with total assets of some $1,650,000. There was no existing credit union movement comparable with the Antigonish movement in the Maritimes and western provinces. The establishment of the credit union movement in Ontario basically took place from 1940 and was given its impetus by the United States National Association of Credit Unions (which was the forerunner of the present CUNA International, Inc.). In consequence, the credit union movement in Ontario is very similar to that in the United States. It is predominantly urban and composed of a large number of credit unions organized with a common bond of occupation and association with relatively few and small community credit unions.[4]

1. Section 8.
2. Section 29(2).
3. Section 4 (1) (b).
4. For an informative account of the history and development of the credit union movement, see "Credit Unions and Caisses Populaires", a working paper, dated November 1962, prepared by Gilles Mercure for the Royal Commission on Banking and Finance. See also Jack Dublin, "Credit Unions, Theory and Practice" (1966), chapter IX.

CHAPTER 2

Leagues and Centrals

1. A second tier in the credit union movement in Ontario is leagues of credit unions incorporated pursuant to Section 53 of the Act which reads as follows:

> "Ten or more credit unions may be incorporated as a league for the objects and purposes of,
>
> (a) protecting and advancing the credit unions that are members of the league;
>
> (b) encouraging and assisting educational and advisory work relating to credit unions;
>
> (c) arranging for group bonding of credit union employees and ensuring repayment of loans made by credit unions to their members;
>
> (d) receiving moneys from its members either as payment on shares or as deposits; and
>
> (e) making loans to credit unions that are members of the league."

Although there are presently four leagues incorporated under the Act, only three are active, the largest of which is The Ontario Credit Union League Limited with a membership, at December 31, 1968, of some 1434 credit unions (for the purposes of this report The Ontario Credit Union League Limited will be referred to as "OCUL"). The remaining leagues serve the caisses populaires in Ontario and are much smaller and more limited in their services. La Caisse Régionale Nipissing et Sudbury Ltée. has 16 affiliated caisses populaires and La Fédération des Caisses Populaires (C.F.) de L'Ontario Ltée. has 50 affiliated caisses populaires. La Caisse Régionale Cochrane et Temiskaming Ltée. is inactive and league services to its 16 affiliated caisses populaires are provided by La Fédération des Caisses Populaires (C.F.) de L'Ontario Ltée. The Committee is advised that there is a proposal to transfer to La Fédération the assets of the inactive Régionale which will thereupon surrender its charter. Most, but not all, credit unions belong to a credit union league. Of the 1,650 active credit unions in Ontario at December 31, 1968, 34 (including 3 caisses populaires) representing about $48,000,000 in assets had chosen not to join any league.

2. The leagues, which are financed by annual dues,[1] provide a variety of services both financial and non-financial covering most aspects of the operations of a credit union and are sometimes referred to as credit unions for credit unions. They play a major role in facilitating the incorporation of new credit unions, preparing the necessary documents and negotiating with the Department on behalf of those seeking incorporation. The leagues also

assist their members in obtaining by-law amendments. Because of their familiarity with the organization, procedure and law relating to credit unions, their views carry weight with the Department. OCUL belongs to Cuna International, Inc. (CUNA), an international association of credit union leagues, through which OCUL is able to arrange for its members the life insurance which is offered by nearly all credit unions on share accounts and on outstanding loan balances of their members, and bonding policies to cover credit union officers and employees.

The leagues also provide educational programs to promote the credit union philosophy of co-operation and thrift and to instruct those members involved in the administration of the credit union in the techniques of credit union management. In OCUL, such services are provided on a highly organized basis through advisory committees available to deal with particular problems of affiliated credit unions and formal courses for the training of credit union personnel. In the other two active leagues, the educational services are more informal and are oriented to meet the somewhat different philosophy of the caisse populaire movement.

3. The basic internal organization of a league is identical with that of a local credit union. They are administered by a board of directors, a credit committee and a supervisory committee elected by and from the membership. OCUL has appointed a loan officer in lieu of the credit committee and an auditor to replace the supervisory committee. La Fédération des Caisses Populaires (C.F.) de L'Ontario Ltée. has replaced its supervisory committee by an auditor but still retains the credit committee while La Caisse Régionale de Nipissing et Sudbury Ltée. operates with both a credit committee and a supervisory committee.

4. Because of its size OCUL is represented locally through 34 unincorporated associations or chapters. Each affiliated credit union is encouraged to join its chapter which elects a local board of directors and supervisory committee to administer its affairs. Chapters also have several committees which work in liaison with committees of the parent OCUL so as to provide league services to individual credit unions through the local chapter.

5. The leagues in Ontario, unlike the leagues in certain other provinces, are empowered under the Act to examine the affairs of any member credit union and are bound to report to the supervisor of credit unions any serious irregularity which is thereby discovered.[2] The Act does not require the leagues to examine their members or stipulate the frequency with which examinations should be carried out. As a matter of practice the periodic examination of credit unions in Ontario is shared between the Department and the leagues. (See Chapter 26, "Supervision").

6. OCUL has also established for its member credit unions a voluntary stabilization fund to provide financial assistance by way of loan or direct grant to affiliated credit unions in financial difficulties. The stabilization fund was financed initially by a contribution of 1/10 of 1% of the shares and deposits of a participating credit union paid to OCUL on the basis of an interest-free 15 year loan. The Committee is advised that all but 11 members of OCUL participate in the stabilization fund which is available only to members of OCUL. The two leagues serving caisses populaires do not operate any similar fund and their members, together with the 34 credit unions not affiliated to any league, are ineligible to participate in any stabilization fund.[3]

7. The leagues in Ontario also provide a comprehensive range of financial services to their member credit unions. Each league, in addition to its educational and advisory functions, acts as a "central" for the receipt of surplus funds of member credit unions invested by way of deposit or shares in the league. These funds are loaned to other member credit unions in temporary need of additional finances or invested in permitted investments under section 35 of the Act. As a primary source of additional funds to meet the seasonal loan and withdrawal demands of local credit unions, league centrals are of considerable importance in maintaining the stability of the credit union movement.

8. Ontario is unusual in having at the same level as league centrals Ontario Co-operative Credit Society (for the purposes of this report Ontario Co-operative Credit Society will be referred to as "OCCS"), which is registered under the Federal Co-operative Credit Associations Act, 1953.[4] Membership in OCCS is open to credit unions and co-operatives in Ontario although most of its business is presently transacted with credit unions.[5] OCCS was incorporated by Private Act in Ontario in 1949[6] to act as a central to credit unions and co-operatives and was sponsored, among others, by OCUL. The original intention appears to have been that the assets of OCUL central would be transferred to the newly incorporated specialized central, but the proposed transfer did not take place. OCCS was registered under the Federal Co-operative Credit Associations Act in 1955. That Act also created the Canadian Co-operative Credit Society Limited which is a national central open to provincial centrals declared eligible to become members. So far only 4 provincial centrals have been registered.[7] Membership in a league by a credit union does not preclude its membership in OCCS or vice versa. OCCS merely provides another central available to all credit unions. About 580 credit unions are affiliated with OCCS, which is in active competition with the central department of OCUL. On several occasions negotiations have been commenced with a view to merging the two centrals as was originally envisaged when OCCS was incorporated.

The Committee is advised that negotiations currently in progress may lead to the merger of these two organizations. In the view of this Committee such a merger would be a desirable step in the consolidation of the financial stability of the credit union movement.

9. It was submitted to this Committee that membership in a league should be made compulsory. The Committee concluded that it would be undesirable in principle to compel every credit union to belong to a credit union league. While strong arguments can be voiced that it is to the advantage of every credit union to be affiliated with a league in view of the variety of services offered by the leagues and the other possible benefits that may result from membership, the Committee considers that, if a credit union wishes to remain independent and not join a league, as some 34 credit unions have currently decided, it should be free to do so. No province expressly requires credit unions to belong to a league, although several provincial credit union leagues have achieved 100% membership through voluntary participation. The Committee considers that it is up to the leagues through their services and efforts to demonstrate to all credit unions the overriding need to be members.

1. The Committee understands that, effective January 1, 1970, the annual dues for member credit unions of OCUL will be $1.50 per member over 18 years.
2. Section 53(8).
3. La Fédération des Caisses Populaires (C.F.) de L'Ontario Ltée. has in the past few years instituted the practice of appropriating $5,000 from its annual profits to a reserve fund to be used for the rehabilitation of affiliated caisses populaires, which it calls a stabilization fund. This fund, which at December 31, 1968 amounted to $30,000, is readily distinguishable from that established by OCUL since it represents a voluntary discretionary reserve to which affiliated credit unions do not directly contribute and in which they have no legal interest.
4. Co-operative Credit Associations Act, S.C. 1952-53, c.28, as amended by S.C. 1968-69, c.31.
5. As at October 31, 1969, 580 credit unions and 161 co-operatives were affiliated with OCCS at which date loans outstanding to credit unions amounted to $9,950,000, compared with $597,000 in outstanding loans to co-operatives.
6. The Ontario Co-operative Credit Society Act, 1949, S.O. 1949, c.133.
7. B.C. Central Credit Union
   Co-operative Credit Society of Manitoba Limited
   Ontario Co-operative Credit Society
   Saskatchewan Co-operative Credit Society Limited.

CHAPTER 3

The Legislation

1. The first statute to deal specifically with credit unions (although the term credit union did not appear in the Act) was The Co-operative Credit Societies Act which was passed in 1922 but, for a reason not apparent to this Committee, was not proclaimed until several years later. This Act was replaced in 1940 by The Credit Unions Act. This latter Act, supplemented and amended on a number of occasions to meet new problems and different conditions arising in the course of the development of the credit union movement in Ontario, still constitutes the basic legislation regulating credit unions in Ontario. Like many Acts built up from a series of amendments passed at different times to meet new situations as they arise, some sections of the Act do not mesh with others and if few sections are in direct conflict there are doubts and uncertainties surrounding the scope and application of a number of provisions. Furthermore, if other provincial legislation is taken as a guide, the Ontario Act is seriously deficient in several respects. It is silent on such basic questions as a stabilization fund, liquidity and audit requirements and perhaps too arbitrary in certain other areas. A few sections are somewhat obscure and at least one provision, that relating to term deposits, is, in the view of this Committee, incapable of any reasonable interpretation. Since it is left to Departmental practice to fill any gaps in the Act and to provide a meaning where necessary, it is not unexpected that the Department experiences some difficulty in interpreting and administering the Act without encountering objections that it is usurping the legislative function. In some instances, such criticism may be valid for in certain "grey" areas, including the limitation on branch offices, the Director may be acting extra-legally, and at least one administrative prohibition relating to the permissible uses of the guarantee fund is in direct conflict with the wording of a section of the Act.

2. In addition to deficiencies in the Act itself, the difficulties of determining the nature and extent of the laws affecting credit unions are greatly increased by the application to credit unions of parts of The Corporations Act.[1] The Act is not and never has been a self-contained code of credit union legislation. Credit unions are corporations "incorporated by or under a general or special Act of the Legislature" and are therefore subject to the provisions of The Corporations Act[2] except where excluded by express provision or by necessary implication. Since The Credit Unions Act makes only one express reference to The Corporations Act in the limited context of the range of permissible investments of a credit union[3], while The Corporations Act makes only two specific references to The Credit Unions Act[4] (in the narrow areas of cumulative voting and the use of the

word co-operative in the name of a credit union), the extent to which The Corporations Act supplements The Credit Unions Act can only be determined by the imprecise and unsatisfactory test of what is not excluded by necessary implication.

3. Apart from the inconvenience of having to make reference to two Acts in order to ascertain fully the law applicable to credit unions, the present legislative framework presents the additional hazard of isolated amendments being made to The Corporations Act without sufficient regard being had to the likely effect of a particular amendment to credit unions. By way of example, the enactment in 1966 of provisions in The Corporations Act to regulate the use and content of proxies and information circulars was undoubtedly not intended to apply to credit unions since, except in the case of corporations, members of a credit union are not permitted to vote by proxy. It seems possible, however, that the limited use of proxies under The Credit Unions Act may well be subject to the provisions of sections 75 to 75g of The Corporations Act. There can be little doubt that the insider trading provisions contained in section 71 of The Corporations Act were not designed to apply to credit unions since each member has only one vote regardless of the number of shares held, the shares have no "market" and are in fact in the nature of withdrawable savings comparable for all practical purposes with deposits. Nevertheless, since the language of section 71 does not clearly exclude credit unions from its application, it seems possible, although highly unrealistic, that the insiders of a credit union must file reports of their shareholdings and any changes relating thereto with the Ontario Securities Commission. The Committee is advised that as a matter of practice the Ontario Securities Commission does not require such reports to be filed by credit union insiders, which is in the opinion of the Committee a sensible position under the circumstances, but it may be questioned whether this concession is necessarily supported by the literal wording of the insider provisions of The Corporations Act.

4. It is undesirable that legislation governing credit unions should be unintentionally and indirectly altered as a result of specialized amendments to The Corporations Act which are intended to be limited to the business corporation but which nevertheless may affect credit unions because of the failure to exclude in clear language the application of such amendments to credit unions. The credit union movement is composed of persons who are in the main unsophisticated in the niceties of statutory interpretation and the present legislative framework which requires the consultation and interpretation of two statutes which do not clearly interrelate does not meet the basic criterion that legislation should be capable of ascertainment and application by those persons which it affects.

5. The Committee recommends the enactment of a Credit Unions Act which would be a self-contained, comprehensive and exclusive code of the legislation affecting credit unions.

1. The Corporations Act, R.S.O. 1960, c.71. as amended, 1960-61, c.13; 1961-62, c.21; 1962-63, c.24; 1964, c.10; 1965, c.21; 1966, c.28; 1968 c.19; The Corporations Amendment Act 1968-69, assented to June 18, 1969.
2. Ibid., sections 2, 17, 242, 285.
3. Section 35.
4. The Corporations Act, sections 64(2), 125(5).

CHAPTER 4

Incorporation

1. Credit unions in Ontario are incorporated by a procedure which so far as can be established is unique. It follows neither the conventional method of incorporation by letters patent nor is it the equivalent of incorporation by memorandum and articles of association. Applications are made by memorandum of association in the prescribed form contained in the Regulation to the Act signed in duplicate before two witnesses by at least 20 subscribers and submitted to the Minister of Financial and Commercial Affairs[1] together with two copies of the proposed by-laws. The Minister has a discretion[2] to approve the application but he may not issue a certificate of incorporation without the written approval of the Director of the Registration and Examination Branch of the Department of Financial and Commercial Affairs, an official responsible to the Minister who, it would appear from the Act, is also vested with an unqualified discretion in the granting or withholding of his written consent to incorporation.[3] Although the concept of incorporation by memorandum of association is unfamiliar in Ontario, and in this unusual form unique among provincial Credit Unions Acts, its use in connection with credit unions in Ontario is well established after some thirty years and with over 1900 credit unions having been incorporated. There would not appear to be any widespread general dissatisfaction with the present procedure expressed by the credit union movement or by those responsible for administering the Act.

2. The granting of a certificate of incorporation to a credit union in Ontario, as in all other provinces, is discretionary. In its first Interim Report, this Committee recommended in connection with the incorporation of a business corporation that any discretion be eliminated and that, subject to compliance with the relevant provisions of the statute, incorporation should be a matter of right.[4] The Committee considered whether the principle of incorporation as of right should be extended to credit unions. There appeared to be no support for such a change apart perhaps from the superficial desire for uniformity with the recommendations made with respect to business corporations and it appeared to the Committee that there are convincing reasons against such a recommendation. A credit union is essentially a financial institution accepting from its members money on deposit and as payment for shares. The intention of persons who may become members is undoubtedly to provide for themselves a method of saving with security and not, as in the case of business corporations, to put their money at risk. It seems to the Committee it is essential, before a credit union is incorporated, for the incorporators to establish that there is a potential membership, that a viable operation will result and that there

is an interest to be served by the incorporation of the proposed credit union. If incorporation as of right were to be extended to credit unions then under the present minimum requirements of the Act any group of 20 persons who could prove a membership bond could become incorporated as a credit union with a limited membership potential and with no prospects of a viable operation. No provincial Act permits the incorporation of credit unions as a matter of right, including those provinces where the normal method of incorporating a business corporation is by memorandum and articles of association and therefore as of right.

3. It was noted in paragraph 1 that a discretion to approve an application for incorporation is vested in both the Minister and the Director. The Act provides in section 6(1)

> " . . . the Minister may in his discretion, refuse to issue a certificate of incorporation or may issue a certificate of incorporation"

and also provides in section 3

> " . . . and a certificate of incorporation may not be issued without the written approval of the Director".

There is thus a double or divided discretion for, unless both the Minister and the Director exercise their separate unfettered discretions in favour of incorporation, a certificate of incorporation may not be issued. The Committee was advised that in practice the actual examination and consideration of applications is handled by the Director who ensures that the memorandum and proposed by-laws are in correct form and, in addition, makes inquiries as to the experience and background of the proposed directors, manager, treasurer and sometimes the incorporators. The requirement of a double or divided discretion in the incorporation of credit unions is unique among provincial Acts, which without exception have a single discretion vested either in the Minister responsible for credit unions or in the provincial equivalent of the Director, upon whose approval of an application to incorporate a certificate of incorporation must be issued by the appropriate Minister. In Saskatchewan, the Registrar himself issues the certificate of incorporation.[5]

4. The Committee received no submissions proposing any change in the method of incorporation. Nevertheless, the Committee considers that the present double discretion is unnecessary and, particularly in the light of the recent legislation which transferred the discretion of the Provincial Secretary to the Minister of Financial and Commercial Affairs, thus vesting two separate discretions in the Minister and an official responsible to the Minister, the Committee concluded that there should be a single discretion vested

in the Minister who would no doubt have the benefit of the experience and advice of the Director but who would be solely responsible for the decision whether to permit incorporation and grant a certificate of incorporation.

5. If a discretion with respect to incorporation is to be maintained, should there be a right of appeal for those who feel aggrieved as a result of the exercise of the discretion? At present, in Ontario, there is no right of appeal and the decision of the Minister or the Director is final. Only one province, Nova Scotia, in its credit union legislation provides for a right of appeal from a refusal to grant a certificate of incorporation.[6] The Committee considers it desirable that a right of appeal be incorporated into the Ontario legislation. The question then arises to what person or body should such an appeal lie. It does not appear to the Committee that the courts should be burdened with the requirement of reviewing a ministerial discretion of this type and that, on balance, the appeal should lie to the Stabilization Board referred to in Chapter 25. It follows that, if there is an appeal from the exercise of the Minister's discretion, he should, if he declines to grant a certificate of incorporation, be required to state in writing to the applicants the reasons for the refusal.

6. The Committee has also considered whether there should be included in the Act some statement of the factors which the Minister should be required to take into account in the exercise of his discretion. The Saskatchewan Act provides that the Registrar must be satisfied that "incorporation is economically advisable" as well as otherwise approving the application.[7] The relevant provision in the British Columbia Act requires that the Inspector shall, before approving an application for incorporation, be satisfied that the subscribers and the proposed directors are residents of the province and are qualified to establish and conduct a credit union and the formation of the proposed credit union will be "for the convenience and advantage of the public".[8] None of the other provincial legislation relating to credit unions contains any such statement. It is questionable whether the Saskatchewan provision actually limits the discretion of the Registrar in granting certificates of incorporation for whether or not the incorporation of a credit union is economically advisable is ultimately a question of opinion. The British Columbia provision (apart from the requirement that the subscribers and proposed directors be residents of the province, which appears in most provincial Acts) does not fetter the discretion of the Inspector as to whether the proposed directors are qualified to establish and conduct a credit union and as to whether it will be for the convenience and advantage of the public, since here again this is a matter of opinion. There is little doubt that such factors as are specifically written into the Acts of Saskatchewan and British Columbia are considered in Ontario by the Director when processing applications for incorporation. The Committee considers that setting out factors which do not effectively limit or qualify

the discretion, and which in any case are considered a matter of practice, would not be a useful addition to the Act.

7. The minimum number of incorporators required under the Act is twenty[9], which is the highest requirement of the various provincial Acts. The minimum number of incorporators in most States is seven. Although a specified number of incorporators is required, there is no provision in the Ontario Act or in the Acts of the other provinces which requires that a credit union have a minimum membership or a minimum pool of assets before it can commence business. In practice, however, the Director will not normally give his written consent to the granting of a certificate of incorporation unless there are at least one hundred potential members. There are isolated instances where the Director has approved incorporation of a credit union with a potential membership of fewer than one hundred persons provided there is a sufficient pool of assets. Normally this occurs only in cases of small, isolated, rural community based credit unions in Northern Ontario which might not be adequately served by other financial institutions. It is evident that a viable financial institution organized as a credit union cannot be established with only twenty members and that the establishment of credit unions should be discouraged unless there is a reasonable assurance that the founding group will be able to attract a sufficient pool of assets. Any provision in the Act relating to minimum membership potential or a minimum pool of assets can at best be arbitrary and could work a hardship in given cases. One advantage of the present system is that the Director, while laying down guidelines for those seeking incorporation, retains a degree of flexibility. The Committee is of the opinion that the present discretionary system is preferable to inserting a fixed minimum organizational potential in terms of minimum membership and minimum pool of assets as prerequisites of the granting of a certificate of incorporation or the commencement of business. The Committee is also of the view there should be no change in the minimum number of incorporators. If there is a real desire and need for the incorporation of a credit union, it will not be difficult to find twenty subscribers to the memorandum. The Committee does recommend that the necessity for having two witnesses to each signature[10] be replaced by the more customary single witness.

8. The Regulation to the Act prescribes that a fee of $20 shall be charged as an incorporation fee. The Committee was advised that the present fee, which has remained unchanged since 1953, is no longer sufficient to cover the Departmental expenses incurred in the processing of applications for incorporation. The Committee recommends that the fee for incorporation be at least equal to the costs involved in processing the application and that a consequent adjustment be made to the amount presently contained in the Regulation.

9. The Committee recommends that:

(a) incorporation of a credit union should not be a matter of right but should continue to be discretionary;

(b) the present double discretion vested in the Director and the Minister relating to the incorporation of a credit union be replaced by a single discretion vested in the responsible Minister;

(c) if the Minister refuses to issue a certificate of incorporation he should be required to state his reasons therefor to the applicants for incorporation;

(d) an appeal should lie to the Stabilization Board referred to in Chapter 25 from the refusal of the Minister to issue a certificate of incorporation;

(e) no provisions be included in the Act setting forth the matters to be considered by the Minister in the exercise of his discretion.

(f) no change be made in the minimum number of incorporators now required; and

(g) it is neither desirable nor feasible to include in the Act any requirement governing minimum membership or minimum assets as a condition of incorporation or carrying on business.

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1. Under Bill 199, The Credit Unions Amendment Act, 1968-69 (No. 2), which became effective on October 31, 1969, the responsibilities of the Provincial Secretary under The Credit Unions Act were transferred to the Minister of Financial and Commercial Affairs.
2. Section 6(1).
3. Section 3.
4. Select Committee on Company Law, First Interim Report, 1967, Chapter I, Section 1. See also Bill 125, The Business Corporations Act, 1st Session, 28th Legislature, Ontario, 17 Elizabeth II, 1968.
5. Saskatchewan Act, section 6.
6. Nova Scotia Act, section 7(6).
7. Saskatchewan Act, section 6.
8. British Columbia Act, section 11(2).
9. Section 5(1).
10. R.R.O., 1960, Reg. 67, Form 1.

CHAPTER 5

Objects and Powers

1. There is some uncertainty as to the nature and scope of the incidental and ancillary powers of a credit union. Section 4(2) of the Act provides that

> "As incidental and ancillary to the objects set out in subsection 1, a credit union may,
>
> (a) make loans to other credit unions;
>
> (b) deposit moneys with and make loans to any league incorporated under section 53 or a predecessor thereof so long only as the amount so deposited or loaned does not exceed 25 per cent of its share capital and deposits;
>
> (c) subject to confirmation by its members at an annual or special general meeting, make donations and gifts out of its surplus income or any undivided earnings, other than the guarantee fund, for the purpose of advancing the interests of the credit union or of credit unions generally."

As a credit union is a corporation to which Part II of The Corporations Act applies, there is some question, particularly in view of section 4(2), whether the incidental and ancillary powers contained in section 22(1) of The Corporations Act apply to credit unions, and, if so, to what extent.

2. Before 1956, section 4 of that Act contained only objects and purposes and it was generally considered that the incidental and ancillary powers in section 22(1) of The Corporations Act applied, mutatis mutandis, to credit unions, except where inconsistent with the objects and purposes contained in section 4 of The Credit Union Act. In 1956, section 4 was amended, rearranging the section to its present format by relegating to incidental and ancillary powers certain provisions which before 1956 were classified as objects and purposes, and adding the power in section 4(2) (c) to make certain donations. The effect of this amendment may have been to exclude entirely the application of section 22(1) of The Corporations Act although the Committee was advised that the amendment was not intended to have such a far-reaching result.

3. Whatever view may prevail as to the effect of the amendment to section 4, the situation is unsatisfactory. If the incidental and ancillary powers of a credit union are limited exclusively to those contained in section 4(2), they are too restrictive. If the effect of section 4(2) is not to deprive a credit union of the benefit of the incidental and ancillary powers contained in section 22(1) of The Corporations Act, then the incidental and ancillary powers of a credit union are, in the opinion of the Committee, too broad.

A credit union should possess certain, but not all, of the incidental and ancillary powers contained in The Corporations Act. In the view of the Committee and without attempting to be exhaustive on the subject, it appears that the incidental and ancillary powers contained in clauses (g), (i), (l), (o), (s) and (v) of section 22(1) of The Corporations Act should be enjoyed, mutatis mutandis, by credit unions.

4. The Committee recommends that the Act be amended to include specifically as incidental and ancillary powers enjoyed by credit unions those contained in the clauses to section 22(1) of The Corporations Act above referred to.

CHAPTER 6

By-laws

1. Section 15 of the Act provides:

"15. By-laws of a credit union may,

(a) prescribe the purposes for which the profits of the credit union may be appropriated;

(b) prescribe the maximum number of shares that may be held by a member thereof;

(c) prescribe the maximum amount that may be deposited by or loaned to a member thereof;

(d) provide for the expulsion and withdrawal of members thereof;

(e) prescribe the form of any instrument necessary for carrying the purposes of a credit union into effect; and

(f) provide for such other matters as are authorized by the regulations."

There must be filed with the Minister, as part of an application for incorporation, two copies of the proposed by-laws of the credit union sought to be incorporated. The Committee understands the Director will only give his approval to the issuance of a certificate of incorporation if the proposed by-laws filed are in the form of the so-called "Revised Standard By-laws 1966" which have been developed through consultation between the Department and OCUL. The Regulation under the Act provides that at a meeting of the subscribers to the memorandum of association "by-laws shall be enacted" but the Regulation does not state that the by-laws which shall be enacted are the proposed by-laws filed as part of the application for incorporation and approved by the Director in connection therewith. This is an inconsistency in the Regulation which it appears should be remedied.

2. After the proposed by-laws filed with the application for incorporation are enacted, the Act provides that no by-law or amendment of a by-law is operative until it has been approved by the supervisor.[1] There is accordingly a discretion in the Department over the by-laws of a credit union, and amendments thereto, both prior to and after incorporation. Since, under the Act, the by-laws of a credit union form part of its charter[2], new by-laws or amendments to existing by-laws represent a change in or alteration of its charter.

3. Section 15 of the Act would not appear to provide a broad enough statutory basis for many of the matters which are included in the by-laws

of a credit union. Section 15 in its present form has appeared in the Act since its first enactment in 1940. Pursuant to the 1940 Act, Regulations were passed which, in effect, prescribed standard by-laws for credit unions. These Regulations were superseded about 1950 when a new Regulation, virtually identical with the present Regulation, was introduced. The effect has been to render subparagraph (f) meaningless and to cast doubt on the statutory authority for a number of provisions of the by-laws which cannot be brought within any of the matters referred to in subsections (a) to (e) inclusive of Section 15.[3] The Committee is of the opinion that Section 15 should be revised to provide a proper statutory base for the by-laws.

4. The Act itself is silent on the procedure for the enactment of a by-law. However, the Revised Standard By-laws provide:

> "The Directors of the credit union may from time to time make by-laws not contrary to the Certificate of Incorporation or The Act and from time to time amend, vary or repeal the same provided that no such by-law, repeal, amendment or variation thereof shall take effect until confirmed or approved by a vote of two-thirds of the members present at a members' meeting duly called for the purpose of considering the same and has been approved by the Supervisor of Credit Unions pursuant to Section 16 of The Act."

It appeared to the Committee somewhat anomalous that the procedure for enacting by-laws should, in Ontario, be contained in Revised Standard By-laws rather than in the Act as in most other provinces. The Committee recommends that the Act itself should set out in detail the procedure to be followed for enacting by-laws of a credit union.

5. In most provinces there are official standard by-laws or rules applicable to all credit unions which are prescribed in Regulations to the relevant provincial Act or by the responsible Minister pursuant to authority contained in the provincial Act.[4] Amendments to such standard by-laws or rules are accordingly made applicable to all credit unions in the particular province, thereby ensuring uniformity among the basic by-law provisions of all credit unions. Where such official by-laws or rules are in force, supplementary by-laws may be enacted by a credit union provided they are not inconsistent with or do not in any way alter the governing standard by-laws, except as permitted by the statute or by the official by-laws themselves. Such supplementary by-laws must receive the discretionary approval of the provincial authority. The Committee considered whether it would be desirable to enact, by Regulation, official standard by-laws which would be applicable to all credit unions as seemed to be the case under the earlier Regulations referred to above. The position in Ontario is that the by-laws of credit unions may vary considerably particularly as a result of individual amendments approved by the supervisor. There would seem to be no

compelling reason for the enactment of official by-laws. To do so would eliminate any flexibility which might be appropriate in a given case and would undoubtedly cause considerable disruption, particularly in the case of older credit unions.

6. The requirement that every by-law or amendment to a by-law be approved by the supervisor before it is effective has been the subject of some criticism which the Committee considers to be justified with respect to by-laws concerned with purely routine matters such as the amendment of the locality in which the annual meeting of a credit union may be held. Such an amendment is unlikely to be so contraversial or of such substance as to require the approval of the supervisor and the requirement for submitting such a by-law for approval constitutes an unnecessary inconvenience to both the supervisor and the particular credit union. Although it would be advantageous to the credit union and to the supervisor to be relieved of what is an irksome requirement in such a case, the Committee does not see how it would be possible to separate those amendments which clearly warrant the prior approval of the supervisor and those which do not. The membership bond and lending limits are clear examples of the former and the location of the annual meeting an example of the latter, but many of the other by-law provisions are perhaps less clear. In the view of the Committee, it is preferable to retain the requirement that all by-laws be subject to the approval of the supervisor despite the inconvenience which is sometimes involved, particularly since the by-laws form part of the charter of a credit union.

7. It was submitted to the Committee that the discretion to approve by-laws and amendments to by-laws be vested in the leagues rather than in the supervisor. It was suggested that the leagues were best suited to pass upon by-laws and amendments because of their general appreciation of credit union problems through their inspection services and other activities in the credit union movement and their specific knowledge of the problems of a particular credit union by reason of its affiliation with that league. It would appear to the Committee that the effectiveness of such a proposal would depend upon every credit union being a member of a league and the Committee has recommended against making membership in a league compulsory.[5] In addition and of greater importance is the fact that the by-laws contain the membership bond of the particular credit union and the Committee considers it would be undesirable in principle to vest in the leagues the responsibility for approving by-law changes which would alter the membership bond. Moreover, under the Act, the by-laws form part of the charter of a credit union and it would seem anomalous to the Committee to permit changes to the charter to be approved other than by the provincial authority. The Committee therefore cannot accept the proposition that the discretionary power to approve by-laws or amendments be vested in the leagues.

8. The Committee recommends that:

(a) the Regulations provide that the by-laws enacted at the first meeting be those submitted with and approved as part of the application for incorporation;

(b) the Act be amended to provide a proper statutory base for the by-laws;

(c) the Act be amended to set out the procedure for the enactment of by-laws; and

(d) the requirement that all by-laws and amendments to by-laws be approved by the supervisor before the same are effective be retained.

1. Section 16(1).
2. Section 6(3).
3. Compare section 67(1) of The Corporations Act.
4. Alberta, British Columbia, Manitoba, Newfoundland, New Brunswick, Nova Scotia, Saskatchewan.
5. See Chapter 2, supra.

CHAPTER 7

Shares

1. Section 19 of the Act provides that a credit union may create a capital divided into shares and states that "the amount thereof, the number of shares, and the payments thereon, shall be determined by its by-laws, but the amount of each share shall in no case exceed $10". Section 20 of the Act provides that "the capital of a credit union may, subject to the by-laws, be increased by subscriptions for new shares or the admission of new members, and it may be diminished by withdrawals". The Revised Standard By-laws provide with respect to share capital that "the value of each share of the credit union shall be $5.00". No maximum number of shares is fixed. The Revised Standard By-laws also provide that "money paid in as payment for shares or instalment of shares may be withdrawn on any day when payment for shares is received, provided that the Board of Directors may require a member at any time to give sixty days' notice of his intention to withdraw any moneys paid in as payment for any share or shares". In keeping with co-operative principles, each member of a credit union has only one vote, regardless of his shareholdings.[1]

2. Shares, so called, in a credit union bear little resemblance to shares in a business corporation. There is no maximum share capital fixed under either the Act or the Revised Standard By-laws (except to the extent that the by-laws of a credit union may fix the maximum number of shares which may be held by any member). Despite the fact that the by-laws normally provide for a period of notice prior to the withdrawal of shares, this requirement is seldom enforced and shares are, in practice, withdrawable on demand. In consequence, the amount received by a credit union as payment for shares will vary throughout the year. While from a strictly legal point of view shares in a credit union may be regarded as risk capital in the event of liquidation, they resemble more closely savings deposits. Members of a credit union receive by way of dividend on shares a discretionary distribution from profits at a rate determined at the end of the financial year.[2] In Ontario the preponderance of savings in a credit union is held in shares rather than deposits largely to take advantage of the life insurance provided by nearly all credit unions on individual shareholdings up to a maximum of $2,000 and this incentive is probably one of the reasons why shares in a credit union turn over at a slower rate than deposits. Despite a right in the by-laws to require notice for the withdrawal of shares and the power of the board of directors to limit withdrawals from share accounts to a proportion of a member's shareholding if it considers that the capital of a credit union has been impaired,[3] credit union shares cannot be regarded as permanent capital.

3. The Committee considered whether a credit union should be required to have a permanent share capital which could not be used by a member as security against a loan or withdrawn except upon withdrawal from membership of the credit union. All other savings would be in the form of deposits. Such a capital structure is proposed in the latest draft of the proposed Manitoba Credit Unions Act. The Committee concluded that the present capital structure of credit unions, although anomalous, has worked well hitherto and that rationalization was not of itself sufficient reason to recommend any major change. To create and limit shareholdings to a class of permanent capital might have the effect of nullifying the advantages of free insurance on individual shareholdings up to $2,000 which is viewed as an important attraction to membership in a credit union.

4. The Committee recommends that no change be made in the present capital structure of credit unions.

1. Section 24.
2. Section 44.
3. Section 20(4).

CHAPTER 8

Membership Bond

1. As a co-operative dealing exclusively in money, a credit union, in keeping with basic co-operative principles, is restricted by statute to accepting moneys from and making loans to its members. However, unlike a typical co-operative in which membership is open to anyone on the basis of similarity of needs (subject only to such membership conditions as may be imposed by the particular co-operative) membership in a credit union in Ontario is limited to persons sharing a pre-existing membership bond coming within a class or kind set out in section 8 of the Act, which provides that "the membership of a credit union shall be limited to persons having a common bond of occupation or association or to persons within a well-defined neighbourhood or community". The membership bond of a particular credit union is contained in its by-laws and not in its certificate of incorporation as might be expected. Under present incorporation procedures, the Department must approve the proposed by-laws of the credit union and this gives the Department an opportunity of reviewing the proposed membership bond to determine if it does, in fact, come within the requirements of section 8. Equally, no amendment to the by-laws may be made without the approval of the supervisor, so that a credit union, once incorporated, may not change its membership bond without the prior approval of the Department. The Departmental interpretation of section 8 is therefore instrumental not only in determining the individual size and scope for development of a particular credit union, but also in governing the growth and competitive position of the credit union movement vis-a-vis other financial institutions. A narrow interpretation can have the effect of producing a large number of independent, small and narrowly based credit unions, while a broader interpretation can result in fewer but larger credit unions which, because of their size, are better able to provide the variety of services offered by competing institutions and increasingly demanded by credit union members. The present requirement that all members of a credit union come within a membership bond and the Departmental interpretation of what constitutes a membership bond within the meaning of section 8 are major matters to be considered in the future development of credit unions and the credit union movement as a whole.

2. The requirement of a membership bond appears to have originated with the caisses populaires Desjardins. Under early Quebec legislation, membership was limited to those persons residing in an electoral district.[1] However, in the early development of the caisses populaires, membership seems to have been limited in practice to the inhabitants of the parish. The principal aim of Desjardins and his followers was to promote thrift

and to establish co-operative savings and credit facilities organized for and administered by communities not adequately served by banks or other financial institutions.[2] A bond of co-operation and confidence among the membership and particularly in those responsible for the administration of the assets of the caisse populaire was essential to the success and growth of early caisses populaires which depended for their funds for loans to members almost exclusively upon the savings of other members invested in the caisse populaire. The parish in semi-rural Quebec at the turn of the century provided the ideal unit for the establishment of caisses populaires. It was reasonably small in area and population and constituted and encompassed a well-defined community made up of persons who, by reason of their daily contacts, were linked by a social bond.[3]

3. The common bond of occupation and association, which is the membership bond most widely used by credit unions in Ontario, was developed when the credit union movement spread to the United States. Its exact origin is obscure but it has been suggested that it was originally a device for the propagation of credit unions and was only later erected into fundamental dogma.[4] In the mid 1920's when credit unions were actively promoted in urban areas by Edward I. Filene and his followers, there was already a well developed banking system and several types of credit-oriented financial institutions were competing for the growing custom of the American consumer in urban residential areas. The credit unions were late comers in the well-diversified American financial system.[5] It may be speculated that the existence of such well-established financial institutions made it difficult to organize successful credit unions on a territorial basis and the invention of a common bond of occupation or association probably provided a means whereby social groupings were created which cut across residential boundaries and provided the credit union movement with new, relatively untapped markets in which it was easier to organize successfully. In the result, the great majority of credit unions in the United States are organized with a common bond of occupation or association.[6]

4. Under The Co-operative Credit Societies Act, enacted in 1922 but not proclaimed until 1928, early credit unions in Ontario were organized on a community basis, since that Act provided that members had to be domiciled within 20 miles of the registered office of the credit union.[7] The enactment of The Credit Unions Act in 1940 provided for the first time the alternative membership bond of a common bond of occupation or association. The influence of the United States credit union rather than the caisse populaire was predominant in the development of the credit union movement in Ontario with the result that a large majority of credit unions were founded with a membership bond based on a common bond or occupation or association rather than on a membership bond based on residence.

5. The distribution of active credit unions in Ontario at December 31, 1968 by types of membership bond was as follows[8]:

Industrial and Commercial	713
Public Service	273
Association Urban	161
Association Rural	10
Religious Urban	228
Religious Rural	76
Community Urban	48
Community Rural	141

In terms of membership and assets the largest credit unions in Ontario are organized with a common bond of occupation and, in contrast with other provinces, over 75% of credit unions presently incorporated are organized with a common bond of occupation or association. The preponderance of the occupational bond is due partly to greater industrialization, particularly in southern Ontario, to the influence of the United States credit union movement in the establishment of credit unions in Ontario and to the effects of a long standing administrative policy which has hitherto given a very restrictive interpretation to the phrase "well-defined neighbourhood or community".

6. Under the administrative policy of the Department the interpretation of "well-defined neighbourhood or community" seems to have been governed as much by the size of potential membership of a credit union in a particular area as by a determination of whether the area truly encompassed a well-defined neighbourhood or community. At one time the maximum size of a community in respect of which a certificate of incorporation would be issued to a credit union was fixed at the arbitrary figure of 4,000. This limit was later raised to 6,000 and still later to 10,000. While the Committee is informed that there is today no such arbitrary numerical limit, it is nevertheless the view of the Department that the potential size of the membership of a community is still the guiding factor and as a matter of policy the Department probably will not permit a membership bond based on residence in a community if the membership potential in that community would be more than 15,000. The present administrative policy would not permit the incorporation of a credit union to serve the residents of any of the cities although these could be said to constitute "a well-defined community".

7. Despite former arbitrary limits of 4,000, 6,000 or 10,000 on the maximum membership potential of a credit union organized in a well-defined neighbourhood or community, and the traditional policy of confining such credit unions to relatively small neighbourhoods or communities, the attitude of the Department has not been absolutely rigid. This is well illustrated by the selective development of credit unions with

a "study club bond". These arose mainly in the case of thriving occupational credit unions organized in an industry that had closed down or moved elsewhere. The common bond of occupation thereupon ceased, but there remained a pool of assets with an organized group of members which might have been operating profitably for some years. Rather than force liquidation of such credit unions, the Director has allowed the membership bond to be changed to membership in a study club with a wider area from which to attract members than would be permitted for a community credit union. The common bond of occupation thus became a common bond of association, but instead of a common bond being the corner stone of the credit union, it is "found" ex post facto in order to preserve a viable credit union where membership had lost its common bond of occupation. To resort to amending a common bond of occupation to membership of a study club in order to create an associational bond would appear to be an expedient device to produce a sensible solution in an unrealistic situation which has indirectly fostered, on a selective basis, what in effect are community credit unions in the guise of a study club. Membership in a study club credit union is open to the former employees of the plant and such other persons who are rendered eligible for membership by joining and attending a minimum number of meetings of the study club organized by the credit union and administered by its officers. The field of membership from which they may recruit persons eligible to become members of the study club and thereby of the credit union is in at least two study club credit unions wider than the present permissible boundaries of a well-defined community. Although such credit unions are in substance community credit unions, they could not have been incorporated as such under present Departmental policy.

8. The opportunities for mergers between credit unions are also dependent upon the prevailing attitude of the Department towards the permissible scope of section 8. Because a credit union may deal only with its members, who in order to be eligible for membership must be within the membership bond of the particular credit union, mergers between credit unions are possible only where the membership bond of the enlarged credit union is such as to render eligible for membership all members of the credit unions constituent to the merger. Consequently, unless the membership bonds of the merging credit unions happen to be identical or overlapping, mergers between credit unions necessitate amendments to the membership bond which, in the case of mergers involving community credit unions, will be permitted only if the potential field of membership of the enlarged credit union is within the restrictive limits imposed by the Department. However, as in the case of study club credit unions, the attitude of the Department towards mergers is more pragmatic; if a merger is desirable in order to preserve the solvency of a credit union, a membership bond will be found.

9. The present administrative policy in Ontario with respect to community credit unions varies with that of other provinces despite basic similarities in the wording of the membership bond provisions in most provincial Credit Unions Acts.[9] There is a city-wide credit union for Saskatoon, and membership in the Sherwood Credit Union which, with some 25,000 members and assets of over $27,000,000 is one of the largest credit unions in Canada, is open to residents of the city of Regina. There are also city-wide credit unions in Vancouver, Calgary and Winnipeg. Under the present practice in Ontario it would not be possible to organize a community credit union in any city of comparable size.

10. In contrast with Ontario, the credit union movements in Manitoba, Saskatchewan, Alberta and British Columbia are centered around community credit unions with occupational credit unions in a minority in number, size of membership and assets.[10] This may be due to the different historical development of the credit union movement in these provinces and particularly to the well established existing system of community co-operatives which provide the basic ideological framework for the organization of credit unions. In addition, the population spread in these provinces may have been partly responsible for the early development of large community credit unions. The Committee is advised that no problems have arisen with respect to large community based credit unions probably due in part to the existence of "professional" management. In fact it has been indicated to the Committee that a large community based credit union may result in a sounder financial institution since it serves a broader cross-section of the population and is less likely to be affected by adverse conditions in a particular industry.

11. Whether or not changes are necessary or desirable, either in the membership bond itself as set out in section 8 or in the Departmental policy, must of necessity lead to a consideration of the purposes, if any, which the membership bond fulfils and the necessity to retain it under present conditions as a basic requirement of a credit union. The membership bond has traditionally been regarded as fulfilling several purposes.

Firstly, it is said that it helps to create a sense of personal involvement among the members. There is incentive to contribute to a local savings and loan institution which is run by and for the benefit of members who are linked together by a common bond, and which is operated by the membership itself through its duly elected directors and committees. In a credit union having as its membership bond the employees of a small plant, the sense of personal involvement and participation may be real and effective, since many of the employees would be known to each other. However, the larger the credit union, generally the more impersonal it becomes and this tends to weaken the sense of personal involvement, particularly when a credit union has reached the size where it must employ "pro-

fessional" help. It is questionable if there is any real common bond in a credit union organized on an occupational basis, with over 13,000 members, other than membership in the credit union itself and certainly the personal involvement of the vast majority of its members must be minimal. The situation is perhaps best summarized in the Report of the Royal Commission on Banking and Finance, at page 161,

> "One should not exaggerate the strength of this sense of involvement because a high proportion of members do not in fact participate actively in the management of locals or even attend general meetings. Nevertheless, it is characteristic that the members feel more closely associated with their caisse or credit union than they do with a bank branch, believe themselves freer to discuss their finances with an officer of a local society, and have more confidence that they will get sympathetic treatment from them than from officials of larger and more remote institutions."

Secondly, credit unions have a low loss ratio and it is claimed that this results in part from the existence of a common bond requirement. It is claimed there is an enhanced duty on the part of the borrower to repay loans which are made from the savings of his neighbour or fellow member. In a small credit union, the credit committee may know the borrower personally or at least be able to obtain references from mutual acquaintances within the membership. Such knowledge may be most valuable in the case of unsecured character loans and can also be useful in assessing the member's current needs, financial resources and proposed security. Larger credit unions usually employ full-time loan officers in lieu of the voluntary credit committee and their whole lending operation is professionally organized. Personal knowledge of member's credit-worthiness which is claimed to exist as a result of the membership bond would seem to diminish as the membership of the credit union becomes larger.

Thirdly, it could be said the common bond requirement facilitates the external and internal control of credit unions by limiting their potential size and scope of operations. The efficacy of the common bond as a means of control depends partly on how far membership after incorporation is confined to persons who are within the membership bond as set out in the relevant by-laws. It is generally agreed that once a certificate of incorporation has been granted it is in practice extremely difficult to check the membership of the credit union in order to ensure compliance with the relevant by-law. The regular examination by the Department or a league does not usually include an inspection of membership lists to determine that all members are within the membership bond. There is also provision in the Revised Standard By-laws to the effect that should a member cease to have the common bond which qualified him to join the credit union either because of change of employment, resignation from the association

or leaving the neighbourhood, the directors may request that member to withdraw.[11] It is understood that this by-law is rarely acted on since management is reluctant to suffer a withdrawal of share capital. In consequence there must be a certain percentage of members of credit unions in Ontario who are outside of the membership bond. The Committee was advised that, in the case of one credit union organized with an occupational bond, consisting of the employees of a particular company, about 2,200 members were no longer employed by the company.

12. It must therefore be considered whether there is any purpose in retaining the common bond as an essential prerequisite for membership of a credit union. Thus far, it would appear that the sense of personal involvement and democratic participation, the added incentive to repay loans and lower ratio of delinquency, which are claimed as desirable consequences of the membership bond, are persuasive only in the case of small credit unions. One might speculate how far a similar sense of participation and close control and the attendant advantages which are claimed to result therefrom might similarly be accomplished merely by placing a numerical limit on the size of any society otherwise open to anyone but organized as a co-operative credit society.

In the course of later development, credit unions have been formed and successfully operated in several provinces with a membership of more than 20,000 administering assets sometimes exceeding $25,000,000. The membership bond in such credit unions has become so attenuated as to be of little significance, because of the size of the membership. The success of such large credit unions, which really operate with no effective bond joining the members except that of membership in the same credit union, is in the view of the Committee due to improved management techniques in the use of loan officers, auditors, etc. although at the expense of the traditional committee structure. If the membership bond has little meaning in the large credit union should it continue to be required without exception for all credit unions? In other words, should a well managed credit union with a successful record be prevented from offering its services to a broader segment of society through the application of a requirement, which although perhaps of importance in the earlier days of the movement, may very well have lost its significance in the emerging pattern of credit unions?

13. The credit union movement in Ontario has experienced rapid growth since World War II. In 1945 there were 266 credit unions with total assets of $6,894,000 compared with 1650 active credit unions with total assets of about $700,000,000 at December 31, 1968. But in common with other provinces, the growth rate has declined in recent years, partly as a result of increased competition from chartered banks, small loan companies, finance companies and, to a lesser extent, the loan and trust companies.

In order to maintain their competitive position, credit unions are constantly having to expand their range of services so as to match those available to credit union members from other financial institutions. Chequing facilities and term deposits are two examples of relatively new credit union services which are likely to become standard.[12] In order to offer their members these new services, credit unions have to be of a certain minimum size either by law in the case of chequing privileges, or from a commercial standpoint.

14. It is not, therefore, surprising that current statistics reveal a continuing trend towards dissolution of credit unions with assets of $50,000 or less. In other provinces, the pressures of increased competition have led to the consolidation of the credit union movement into fewer and larger units by mergers and the use of branch offices in order to preserve credit union representation in areas too small to support a viable independent credit union of a size able to compete with other financial institutions. This has not occurred in Ontario, where there are still over 600 credit unions with assets of less than $100,000, because of policy restrictions upon the size of community credit unions, the use of branch offices and mergers.

15. Although the credit union movement in Ontario is principally composed of occupational credit unions, the Committee is of the view the future growth of the movement rests in the development of community based credit unions. The reasons for this conclusion are twofold. Firstly, the Committee considers that as a matter of principle, every person should have the opportunity to avail himself of the services of a credit union if he so wishes. As the Act is presently applied, membership of a credit union is restricted to a minority of the population in Ontario whose place of employment happens to have an occupational credit union, those who are members of a church or club which has organized a credit union with a bond of association, those who live in an area small enough to constitute a well-defined neighbourhood or community as presently interpreted and in which a community credit union has been organized, or to members of the so-called study club. The only means by which most persons will be rendered eligible for membership in a credit union is through the expansion and development of community credit unions since they alone are capable of reaching large segments of the population. Secondly, the growth of occupational credit unions is inhibited by their narrow membership base. An occupational credit union may recruit members only from the employees (and sometimes their dependants) of the firm in which it is organized, and while the actual number of employees depends upon the employment policies of the particular firm, it is likely that in most cases the field of membership will be smaller than that in many community credit unions even as presently interpreted by the Department. There is some evidence that certain large occupational credit unions are nearing

the limit of their potential growth and the Committee is aware that applications are being made in several cases to amend the membership bond to a community bond, which would enable such credit unions to expand beyond their present membership limits imposed by industrial or occupational bonds. However, in view of the prevailing policy towards large community credit unions, industrial or occupational credit unions are not usually able to expand their membership base by change of bond. Equally, occupational credit unions are more susceptible to the adverse effects of a local economic slowdown, strikes or lay-offs than a community credit union whose membership is likely to include a broader cross-section of trades and occupations. The question of administrative policy with respect to the interpretation and application of section 8 "a well-defined neighbourhood or community" is, therefore, central to the question of the future development of the credit union movement in Ontario.

16. There will always be a place for a number of smaller credit unions organized in parish communities in which the members are linked by a genuine social bond and prefer local control over their savings and a closed membership to the advantages of the greater range of services a larger credit union would offer. The same is true of many credit unions formed with an ethnic bond of association. The advantages of saving or making loan repayments by payroll deduction and the convenience of in-plant banking are factors which may encourage the continuance of a number of occupational or industrial credit unions.

17. However, the Committee is of the view that the Act should provide a framework whereby any credit union, which is unable to provide the services which its members require and should have, should be able to amalgamate or transfer its assets to a larger and well established credit union or amalgamate with other credit unions to form a viable unit. This, in the opinion of the Committee, could best be accomplished through the creation of community based credit unions. The consolidation of the credit union movement may tend to accelerate the development of credit unions into impersonal financial institutions in which the members feel little sense of personal involvement, but this appears to be a necessary consequence if the movement is to grow and prosper.

18. Accordingly, the Committee recommends that a broader interpretation be given to section 8 of the Act so as to facilitate those credit unions which seek to change their membership bond to a community bond without the imposition of a limitation on the size of the community to be served. The test should be not the size of the community, but rather the managerial capacity and past record of the credit union seeking to serve an enlarged membership. Whether or not adequate management exists is a matter which should be determined by the Department at the time the credit union seeks to amend its membership bond. The same principle

should govern the incorporation of a credit union. There should be no arbitrary limit set on the size of a community to be served by a credit union seeking incorporation: rather the test should be the availability to such proposed credit union of competent management, a factor which the Department takes into account in the incorporation of any credit union.

19. Some of the present difficulties may result from the language of section 8 and in particular the use of the words "well-defined neighbourhood" with its connotation of smallness and which may have encouraged the present restrictive approach towards the establishment of community credit unions. However, it should be noted that section 8 does provide for two separate, independent, alternative territorial units within which a credit union may be organized, ie. a "well-defined neighbourhood or community" and in our view the word "community" does not necessarily presuppose a small community of 10,000 to 15,000 persons. Nevertheless, to remove any possible legislative restrictions upon the development of larger community credit unions and in order to implement the recommendations of the Committee in this respect, it is recommended that section 8 be amended to provide that membership in a community credit union be open to "persons residing or working within a metropolitan area, city, town or other reasonably well-defined community".

20. If, as the Committee recommends, section 8 of the Act is amended and interpreted so as to clarify and relax the present membership bond requirement in order to encourage and facilitate the development of large community credit unions having a broadly based membership with the principal criterion for expansion being demonstrable managerial competence and efficiency, the Committee envisages the development of several large community credit unions catering to a very wide field of membership which would, in our opinion, in effect be operating without a membership bond requirement except in name. This, the Committee understands, is the position already reached by several credit unions with city-wide membership bonds in other provinces. Rather than preserve the fiction of a membership bond requirement where the credit union is permitted to serve a large community, it would be more accurate and, in the Committee's view, preferable to state that such credit unions deal only with members but operate without any membership bond as such.

21. If, as the Committee believes, the only real bond among the members of a large credit union is the bond resulting from membership of the same credit union and if the main purpose today of the membership bond is to ensure the stability of a credit union by preventing it from expanding beyond its managerial capacity which it would otherwise be free to do were the field of membership not limited, we see no ideological or practical

reason for imposing a membership bond requirement upon all credit unions.

22. We do not recommend the deletion of the membership bond requirement from the Act since we consider that in most cases it serves as a valuable check on the uncontrolled expansion of credit unions. Indeed, many credit unions may well want to continue operating within the field of a narrower membership bond requirement and should not be prevented from doing so. The Committee considers and recommends, however, that where a credit union has attained a certain size and is operating to the satisfaction of the Director, with a field of membership so wide as to render the membership bond of no real significance, such credit union should be permitted to apply for the elimination from its by-laws of a formal requirement of a membership bond and be authorized by the Director to draw its members from such areas as it considers it can conveniently serve and not merely from within its territorial boundaries, however wide. This we consider would enable credit unions to provide improved and more varied services and by removing any fixed tie to a particular community would enable such a credit union to expand freely and on an equal basis with other financial institutions which may well be essential to the future development of the credit union movement and for its stability. The credit union, which is a co-operative, would thus be permitted to operate on the co-operative principle of open membership based on a similarity of needs of the members.

23. Credit unions should not be permitted to incorporate without a membership bond requirement. This privilege should be restricted on a revocable basis to those credit unions which have established to the satisfaction of the Director their ability to cater to a larger membership. There should also be imposed upon such "open bond" credit unions certain additional safeguards in recognition of their different status and added responsibilities in serving an unlimited community. In our view such controls should include but not be limited to additional audit requirements, closer supervision and perhaps a different statutory liquidity base for savings and borrowings. The continued exemption of such credit unions from the requirements of The Securities Act might also have to be re-examined.

24. The Committee envisages and recommends the establishment of two tiers of credit unions, those operating with and those permitted to operate without a membership bond, but both being required to deal only with their members which we view as the essential distinguishing feature of a credit union.[13]

25. The recommendations of the Committee with respect to the broadening of the membership bond are closely allied with its recommendations

concerning the financial stability of credit unions contained in Chapters 23, 24, 25, 26 and 27 and are dependent upon those recommendations being implemented as necessary safeguards.

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1. The Co-operative Syndicates Act, S.Q., 1906, c.33, section 1, provided that "the by-laws shall define the limits of the territory within which the association shall operate and which shall, in no case, exceed the limits of a provincial electoral district."

   The Savings and Credit Unions Act, R.S.Q. 1964, c.293, section 7, as amended, which currently governs caisses populaires and credit unions, provides as follows: "the territory described in the founding memorandum shall not, without the authorization of the Minister of Financial Institutions, Companies and Cooperatives exceed the limits of one electoral district or municipality."
2. The Report of the Royal Commission on Banking and Finance noted at page 161 that some 500 caisses populaires were located in areas which were not served by bank branches.
3. An account of the origins and development of the Quebec caisse populaire may be found in section 1 of the submission, dated June, 1962, of La Fédération de Québec des Unions Régionales des Caisses Populaires Desjardins to the Royal Commission on Banking and Finance.
4. "Credit Unions and Caisses Populaires", a working paper, dated November, 1962, prepared by Gilles Mercure for the Royal Commission on Banking and Finance, page 25.
5. Ibid., page 22.
6. Over 75% of credit unions in the United States are organized with a common bond of occupation or association. International Credit Union Yearbook 1969, page 9.
7. The Co-operative Credit Societies Act, S.O. 1922, c.64, section 26.
8. Summary of Business prepared by the Credit Union Section of the Registration and Examination Branch of the Department of Financial and Commercial Affairs, 1968.
9. *Saskatchewan* ". . . the membership of a credit union shall be limited to groups of persons having a common bond of occupation or association, or to groups within a well-defined neighbourhood, community, or rural or urban district". Saskatchewan Act, section 39.

   Alberta ". . . the membership of a credit union shall be limited to groups of persons having a common bond of occupation or association, or to persons within a well-defined neighbourhood, community, or rural or urban district". Alberta Act, section 48.

   Manitoba ". . . society membership shall be limited to groups of persons having a common bond of occupation or association, or to groups within the same neighborhood, community, or district". Manitoba Act, section 42(3).

   In the latest draft of the proposed new Manitoba Credit Unions Act, the membership bond provision has been elaborated and perhaps widened. For those credit unions required to operate with a membership bond, the draft Act provides that: "Credit unions membership . . . shall be limited to groups having a common bond of occupation or association, or to the residents within a well defined neighbourhood, community or rural or urban district, including a rural trading area, employees of a common employer or members of a bona fide fraternal, religious, co-operative, labour, rural, educational or similar organization, and members of the immediate family of such persons". Proposed Manitoba Credit Unions Act, draft 4, dated September, 1969, section 30(5).

   British Columbia ". . . Admission to membership in a credit union shall be limited to persons coming within any of the following classes; that is, persons

   (a) having a common bond of occupation;
   (b) having a common bond of association;
   (c) residing or working within an identifiable neighbourhood or community; or
   (d) who are members of another credit union and have been recommended for membership in writing by that credit union; and such other classes of persons as are defined in the common bond approved by the Inspector of Credit Unions". British Columbia Act, section 21.

10. Statistics derived from Annual Reports of the provincial authorities of the relevant provinces indicate the following distribution of credit unions classified according to occupational and community membership bonds as at December 31, 1968.

	Total active credit unions	*Occupational*	*Community*
Alberta	269	67	129
British Columbia	256	102	116
Manitoba	239	69	115
Ontario	1650	986	189
Saskatchewan	284	27	241

11. Revised Standard By-laws, 1966, article II, clause 5.
12. See generally, Proceedings of the 15th Interprovincial Conference of the National Association of Administrators of Co-operative Legislation, 1968, pages 28-30.
13. No provincial Act has yet permitted by its express terms the establishment of "open membership" credit unions. Draft 4 of the proposed Manitoba Credit Unions Act, Part III, would permit credit unions which satisfy certain conditions to operate without a membership bond.

CHAPTER 9

Branches

1. Closely allied to the Departmental policy of limiting the potential size of community credit unions is the reluctance of the Department to permit credit unions to conduct branch operations. The Act is silent on the right of a credit union to establish branches and, although it might be argued that this is a right reasonably incidental to the operations of a credit union, the present administrative policy in Ontario does not permit credit unions to open branch offices. The legislation in certain other provinces is also silent on the right of credit unions to establish branches, but in most of these provinces branch offices are in general use.

2. Although the Department does not permit credit unions to operate branches, it has authorized certain credit unions to operate so-called collection points. Originally the basic distinction between a branch and a collection point was that a collection point was an outlet only for receipt of deposits and staffed by a credit union collector, whereas a branch office offered in addition all other facilities and services of a particular credit union. This distinction has become blurred because the Department now accepts that a collection point can also provide other credit union services, including withdrawal facilities, provided that all the accounting of a credit union is carried out at the head office and separate accounts are not kept by the collection point. So long as no separate accounts are kept, the Department does not consider the so-called collection point as a branch.

3. Apart from the question of accounting, there seems to be little difference between a collection point in its operations and a branch. If, as the Committee has recommended, section 8 of the Act and its interpretation are broadened to permit community credit unions of a larger size, it necessarily follows that such credit unions, to offer complete and convenient service to members, must be permitted to open branches. Any accounting requirements and procedures which the Department feels necessary in connection with the establishment and operation of a branch could be detailed in Regulations to the Act.

4. The Committee recommends that the Act contain a provision permitting credit unions to open and operate branches, subject to such conditions as may be prescribed by Regulations.

CHAPTER 10

Mergers

1. In Chapter 8 the Committee noted the limitations on the opportunities for mergers between credit unions resulting from the current restrictive administrative interpretation of the membership bond provisions. If the recommendations of the Committee in Chapter 8 are implemented the result should be to facilitate mergers between credit unions thereby eliminating any present criticism of the restrictive policy toward mergers. There remain for consideration the procedures available under the Act for effecting mergers between credit unions.

2. Mergers between credit unions may be effected under the Act either by amalgamation or by sale and purchase of assets.

3. The Act provides in section 56 that any two or more credit unions may amalgamate and continue as one credit union. The procedure for amalgamation under section 56 is very similar to that presently provided under section 96 of The Corporations Act. The amalgamation agreement must be approved by two-thirds of the members present and voting at a general meeting of each of the credit unions involved and submitted to the Minister for his discretionary approval and the issue of a certificate of amalgamation. There is no requirement that the amalgamation agreement, prior to its adoption by the members, be approved by or even submitted to the Minister or the Director or supervisor. Until the recent amendment to the Act vesting in the Minister of Financial and Commercial Affairs the functions of the Provincial Secretary with respect to credit unions it would have been technically possible for credit unions to amalgamate without reference to the Department, and it is perhaps for this reason that the Committee is advised that as a matter of Departmental practice mergers between credit unions could be carried out only by means of sale and purchase of assets pursuant to provisions of section 57 of the Act.

4. Under section 57 the proposed agreement for the purchase and sale of assets must be submitted to and approved by the Director before it can be presented to the members of the credit unions concerned for their approval. If the approval of the Director is obtained the sale and purchase agreement must thereupon be approved by three-quarters of the members present and voting at a general meeting of each of the credit unions concerned.

5. In the view of this Committee the present statutory procedures governing the merger of credit unions and the administrative limitations imposed upon the methods for carrying out mergers are unsatisfactory. It is unde-

sirable in principle and unsupportable in law that credit unions wishing to merge by amalgamation should be prevented from doing so by an extra-legal prohibition imposed by the Department in the face of an express procedure contained in the Act for the amalgamation of credit unions and be required to effect the proposed merger by sale and purchase of assets. But it is also undesirable that the alternative procedures in the Act for the effecting of mergers between credit unions should be so widely divergent in their requirements. In particular the Act should not afford a means to credit unions to by-pass completely the Director who is charged with the administration of the Act, especially as mergers between credit unions almost always necessitate the enlargement of the membership bond so that the resulting credit union may accommodate the members of the merging credit unions.

6. Accordingly the Committee recommends that while a credit union should be free to select the method of accomplishing a merger it deems most convenient, there should in every case be a requirement that the merger agreement be approved by the Director. Since this is presently required only in mergers by means of sale and purchase of assets, the Committee recommends that section 56 be amended to provide as in most provincial legislation that the proposed amalgamation agreement be approved by the Director before its submission to the members in general meeting. The Committee also recommends that the vote of members required to approve an agreement for the sale of assets be reduced to a two-thirds majority of members present and voting at the meeting, which is the vote required for the adoption of an amalgamation agreement.

CHAPTER 11

Membership

Minors

1. Minors of any age are eligible for membership in a credit union in Ontario, but are ineligible to hold office in the credit union.[1] In contrast with most provincial Acts, however, minors who are admitted to membership of a credit union in Ontario possess equal voting rights with other members but cannot borrow in excess of their savings unless secured by a promissory note signed by a competent adult who is jointly and severally liable on the loan. The provisions governing the admission and membership rights of minors are found in section 25 of the Act which reads as follows:

> "Subject to the by-laws, a person under the age of twenty-one years may be a member of a credit union, and every such person may enjoy all the rights of a member and execute all instruments and give all acquittances necessary to be executed or given under the by-laws, but shall not be a trustee, manager, treasurer or a member of the board of directors, credit committee or supervisory committee of the credit union and does not have the right to borrow any amount in excess of his savings in the credit union except upon a joint and several promissory note signed by him and by a person over twenty-one years of age."

The Revised Standard By-laws do not qualify or enlarge upon the membership rights of minors and provide that "Subject to the provisions of Section 25 of the Act a person under the age of twenty-one years may be admitted as a member of the credit union in the same manner as persons over the age of twenty-one years may be admitted."

2. Some provincial Acts for the purpose of membership rights of minors distinguish between minors under 16 years and those between 16 and 21.[2] Members under 16 years are junior or auxiliary members who may not vote. In Quebec it would appear that a minor of any age cannot vote.[3] Having regard to the basic principle of one vote per member regardless of the number of shares held and the incapacity of very young members to exercise an intelligent choice, there is perhaps a possibility that a parent member who opens a share account for very young children could, in effect, gain additional voting rights. The Committee, therefore, recommends that minors under 16 years should have no right to vote.

3. In several provincial Acts no prohibition is placed upon the making of loans to minors although a restriction can reasonably be inferred in the case of young members in the discretion of the credit committee or

the loan officer in approving loan applications. In such provinces a credit union is free to determine by by-law or otherwise its policy relating to loans to minors. In Ontario, however, the position is somewhat exceptional and illogical, since the Act grants unqualified voting rights to minors of any age, but prohibits loans to all minors in excess of their savings without the joint and several guarantee of a competent person. The joint and several promissory note of a competent adult may not be necessary in order to recover money borrowed by a minor since the general law which renders loans of money to persons under 21 void may have been effectively superseded by section 27(1) of the Act which provides as follows:

> "All moneys payable by a member to a credit union are a debt due from the member to the credit union and are recoverable as such in a court of competent jurisdiction."

The Ontario Law Reform Commission in its Report on the Age of Majority and Related Matters recommended that the age of majority be lowered to 18 years and that section 25 of the Act be amended accordingly. The Committee agrees with this recommendation but feels that further rights should be afforded to minors with respect to borrowing. In the view of the Committee, the right to borrow should, in principle, be concomitant with the right to vote and, since the Committee recommends that minors of 16 years and over be entitled to vote, the Committee recommends that a credit union be permitted to make loans to minors 16 years and over in excess of their savings and without the added requirement of a promissory note signed by a competent person. The ability of a minor to borrow should be determined as a matter of credit assessment. If a particular credit union wishes to restrict this right it should be permitted to do so by by-law.

4. The present requirement under section 25 of the Act to the effect that officers, directors and members of the credit committee and supervisory committee be members 21 years and over should be relaxed since some credit unions may consider it desirable to encourage younger members to participate in the administration of credit union affairs even though it may be unlikely that minors would be elected to office in many credit unions. The Committee therefore recommends, consistent with the recommendations of the Ontario Law Reform Commission, that minors 18 years and over be eligible for election as directors and members of the credit or supervisory committee and to hold office in a credit union. In view of possible difficulties arising from the general law concerning the enforceability of contracts made with minors, the Committee recommends that a section be included in the Act that, where a director, officer or member of a credit committee or supervisory committee under the age of 21 years contracts on behalf of the credit union, he shall be deemed to possess the contractual capacity of a person sui juris.

5. The status of a credit union with respect to a deposit or chequing account of a minor is not dealt with in the Act and it would appear to

the Committee desirable if the Act included a section similar to section 93 of The Loan and Trust Corporations Act.[3]

6. The Committee recommends that:

(a) a minor under the age of 16 should not be entitled to vote;

(b) a credit union should be permitted to loan money to a minor 16 years of age and over in excess of his shares and deposits and without a promissory note signed by an adult, subject to the by-laws of the credit union;

(c) minors of the age of 18 years and over be eligible to be elected directors and members of the credit committee or supervisory committee and to hold office in a credit union; and

(d) a section be added to the Act similar to section 93 of The Loan and Trust Corporations Act.

1. Section 25.
2. e.g. British Columbia, Saskatchewan, New Brunswick.
3. Quebec Act, section 22.
4. Section 93 of The Loan and Trust Corporations Act, R.S.O. 1960, c.222, provides:
"A person not of the full age of twenty-one years may deposit money with a registered corporation in his own name, and the money so deposited may be repaid to him, and he may give a valid discharge therefor, notwithstanding his minority."

CHAPTER 12

Membership

Corporations and Unincorporated Associations

1. While it is difficult to visualize a corporation or an unincorporated association as a member of a credit union in view of the membership bond requirements, except perhaps in a credit union with a community bond or to a lesser extent in a credit union organized with a membership bond of common association, the Act has always recognized the right of a corporation to be a member of a credit union. Prior to an amendment in 1969, the Act contained no restrictions on the right of corporate membership since section 23, prior to amendment, provided "any corporation may become a member of a credit union". A Departmental ruling, however, imposed the restriction that 51% of the voting shares of the corporation be registered in the names of members of the credit union in order to render the corporation eligible for membership. This Departmental ruling was embodied as an amendment to the Act in 1969 which now provides with respect to corporate membership,

> "Section 23(1). A corporation may become a member of a credit union where,
>
> (a) in a case of a corporation having share capital the persons holding equity shares carrying at least 51% of the voting rights attached to all equity shares of the corporation for a time being outstanding are members of that credit union;
>
> (b) in the case of a corporation without share capital, at least 51% of the members of the corporation are members of that credit union."

Despite the restrictions in the above quoted section, there would still appear to be a lacuna in the provision governing the admission of corporate members with share capital, since section 23 requires that only 51% of the voting shares be held by members of the credit union. Apart from the possibility that the beneficial owners of such shares may not be members of the credit union, a corporation would apparently be eligible for membership if one shareholder who was a member of the credit union held 51% of the voting shares registered in his name while the remaining 49% of the voting shares were widely distributed among shareholders who were not members of the credit union.

2. The Act is silent upon the eligibility for membership of unincorporated associations in a credit union except by an indirect reference in section 24 which allows agricultural associations, municipal bodies and school boards to vote by proxy. However, the Committee is advised that the

Department does permit unincorporated associations, a majority of the members of which are members of a credit union, to join that credit union. There appears to be no essential difference in principle between membership by a corporation and membership by an unincorporated association and it is recommended that the Act specifically provide that an unincorporated association may become a member of a credit union.

3. The limitation on the right of corporations and unincorporated associations to membership in a credit union is a matter of some concern. If, as the Committee has recommended (Chapter 8), credit unions be allowed to operate with an unlimited membership bond, there should and need be no restrictions on the right of a corporation or unincorporated association to become members. However, restrictions would appear to be required in the case of credit unions which will continue to operate with a membership bond so as to ensure that the membership bond of the particular credit union is shared to some extent at least by the members of the corporation or unincorporated association. The present provisions of the Act relating to the conditions for the membership of corporations are not applicable to unincorporated associations and in the view of the Committee a better test, which would be applicable equally to corporations and unincorporated associations, is one based on the composition of the membership of the corporation or unincorporated association. Any restriction of this kind is bound to be arbitrary and probably imprecise, but the Committee recommends the adoption of a provision similar to that in the Manitoba Act, to provide that in the case of a credit union with a membership bond, corporations and unincorporated associations may become members provided that the shareholders or members, as the case may be, are for the most part composed of the same general group as the members of the credit union.

4. Under section 23(2) of the Act, loans to corporations are made subject to special procedural requirements:

> "A credit union shall not make a loan to a member that is a corporation unless the loan is approved by a joint meeting of the board of directors, the credit committee and the supervisory committee of the credit union."

No similar provision exists with respect to loans by a credit union to an unincorporated association, but we are advised that the Department prohibits such members from borrowing from the credit union. The provisions of the Revised Standard By-laws which deal with the maximum amount of any loan and the minimum security required do not distinguish between individuals, corporations or unincorporated associations, but refer only to members and might be interpreted as authorizing loans to unincorporated associations. The Committee is of the opinion that, if the Act is amended to recognize the right of an unincorporated association

to become a member, such an association should be given the right to borrow subject to the same conditions as those which exist for corporations.

5. Since the Committee feels that member corporations and unincorporated associations be subject to identical requirements with regard to borrowing from a credit union, the question arises as to what requirements, if any, additional to those now provided should be imposed upon loans to member corporations or unincorporated associations. There is little uniformity among provincial Acts with regard to loans to member corporations and unincorporated associations. The provisions range from a blanket prohibition upon all such loans without the approval of the governmental authority to restrictions upon the amount a credit union may lend to a member corporation or unincorporated association and/or a special procedure for approving such loans. The Committee is of the view that the policy with regard to making loans to member corporations and unincorporated associations should not be governed by legislation but should be left to the discretion of each credit union. The present restriction in section 23 with respect to loans to corporations would appear to be satisfactory and should be extended to loans to unincorporated associations. In addition, the Act should specifically provide, that if any member of the board or the credit or supervisory committee is a director, officer, shareholder or member of the corporation or unincorporated association seeking the loan, he disclose his interest and refrain from voting.

6. The Committee recommends that:

(a) in the case of a credit union operating with a membership bond, corporations and unincorporated associations be eligible for membership provided that the shareholders or members thereof are for the most part composed of the same general group as the members of the credit union;

(b) in the case of a credit union which may in the future be permitted to operate without a membership bond, there should be no restrictions on the right of corporations and unincorporated associations to be members; and

(c) credit unions be empowered to make loans to both member corporations and unincorporated associations, but that loans to such members be approved by a disinterested majority of the board of directors, credit committee and supervisory committee meeting jointly.

CHAPTER 13

Internal Administration

General

1. As originally conceived, the management of a credit union was divided among a board of directors, a credit committee and a supervisory committee which were to be separate, independent, autonomous bodies elected by the membership with defined powers and duties demarcated by a series of checks and balances so as to prevent any overlapping or usurpation of functions. This separation of powers and duties in the tripartite management structure can perhaps best be illustrated in the context of the typical lending transaction which may be divided into three stages. The board of directors determines the general lending policy of the credit union subject to the by-laws and the Act including such matters as the amount available for loans, the rate of interest to be charged and the general requirements regarding the permissible types of loan security. The credit committee considers individual loan applications from members determining in each instance whether to make the particular loan and if so on what conditions and with what security, if any. The supervisory committee in the course of its duty to exercise surveillance over the financial affairs of the credit union and to make regular examinations and audits of the credit union books, ensures that the board in its lending policy does not contravene the Act or by-laws and that each individual loan granted by the credit committee conforms to the lending policy laid down by the board and, in the case of secured loans, that the agreed security has in fact been taken. So long as a credit union remained a small, relatively unsophisticated financial institution, the tripartite committee structure worked reasonably well and perhaps had the added advantage of actively involving a number of the members in the administration of credit union affairs. The growth and development of the credit union movement in Ontario and elsewhere and the consequent need to enable credit unions to adopt a managerial structure better suited to meet the exigencies of competition is reflected in the gradual but continuing erosion and, in some larger credit unions, the elimination of the traditional committee structure and its replacement by a board of directors with increased powers assisted by qualified professional management appointed from outside the membership to perform some or all of the functions formerly entrusted to the credit committee or supervisory committee.

2. The Committee considers that its recommendations with respect to the membership bond, which hopefully will encourage the growth and consolidation of the credit union movement, will inevitably accelerate the trend towards professionally managed credit unions. However, the Com-

mittee is conscious of the need to preserve, as far as possible, the democratic traditions and opportunities for participation of the members in the management of credit unions which are perhaps placed in question when the members' committees are replaced by professional management and the powers originally divided between the board of directors and two committees end up being exercised by the board of directors aided by officers and employees generally appointed by and responsible to the board of directors. In addition to specific amendments with regard to the provisions governing the board of directors, the supervisory committee and the credit committee, it therefore seemed appropriate to this Committee to recommend that the Act be supplemented by additional statutory rights accorded to members. These matters are examined in Chapters 14, 15, 16, 17 and 18.

CHAPTER 14

Internal Administration

Directors and Officers

1. The board of directors, which under the Act must number "at least five",[1] is the policy making body of the credit union. Section 30(2) of the Act prescribes the functions of the board as follows:

> "The board of directors shall perform such duties as are prescribed by this Act, the regulations, and the by-laws of the credit union."

The specific duties conferred upon the board of directors in the Act generally arise where some or all of the functions of the credit committee and the supervisory committee are reassigned to the board of directors upon the appointment of a loan officer or an auditor and these are considered separately under the recommendations of this Committee concerning the credit committee and the supervisory committee (Chapters 15 and 16). The single Regulation to the Act presently in force does not in any way relate to the powers and duties of the board of directors. The basic duties and functions of the board of directors are set out in Article VII of the Revised Standard By-laws as follows:

> "Subject to these by-laws the Board of Directors shall manage the affairs of the credit union and it shall be more particularly their duty to:
>
> (a) act upon all applications for membership and the expulsion and withdrawal of members.
>
> (b) fix the amount of the bond which shall be required of any officer having the custody of funds.
>
> (c) determine, from time to time, interest rates and fix the maximum number of shares which may be held by and the maximum amount which may be deposited by any member of the credit union.
>
> (d) recommend to the annual meeting the payment of dividends and when deemed advisable to recommend the partial refunding of moneys received as interest on loans.
>
> (e) have charge of investments other than loans to members.
>
> (f) recommend amendments to the by-laws.
>
> (g) designated the bank, Province of Ontario Savings Office, Ontario Co-operative Credit Society or Trust Company licensed to carry on business in Ontario in which the funds of the credit union shall

be deposited and designate the person or persons who may sign and countersign cheques on behalf of the credit union.

(h) employ, fix the compensation and prescribe the duties of such employees as may, in the discretion of the Board of Directors, be necessary.

(i) act upon any application of a member for the postponement of any payment or payments on a loan.

(j) perform all duties and take all precautions necessary for the interest of the credit union not within the jurisdiction of the general meeting and not inconsistent with the Act, the regulations and these by-laws and perform such other duties as the members may from time to time designate."

2. The board of directors presently has power to determine the interest rate payable on deposits by the credit union but is limited to making a recommendation only regarding the amount of any dividend and rebate of interest. Section 44 of the Act vests in the members the right to declare a dividend upon the recommendation of the board, but the Act is silent on the right of the members to declare a rebate of interest, although in practice rebates are declared at the annual meeting. A submission was received proposing that in Ontario the power to declare dividends and rebates of interest should be vested in the board of directors. Despite technical and legal differences between a dividend on shares and interest on deposits within the particular context of a credit union, both are regarded essentially as returns on the savings of members, the amount of which would appear to be properly a question to be decided by the board of directors. The Committee is of the view that it is therefore preferable to vest in the board of directors the power to determine and declare dividends on shares and rebates of loan interest. In addition, the Act should provide specifically for the right of a credit union to rebate loan interest.

3. Directors of credit unions are elected by the members in general meeting. Pursuant to the provisions of section 30(3) of the Act, the Revised Standard By-laws provide for the election and retirement of directors in rotation, the effect of which is that a director holds office for three years, the maximum term permitted. Once elected, there is no means under the Act for the removal of a director by the members before the expiration of his term of office apart from the one exceptional instance under section 32(9) where the members in general meeting may vote by a two-thirds majority to dismiss a director who has been suspended from office by the supervisory committee because of a misappropriation or misdirection of

credit union assets. There is in addition a power under section 30(7) of the Act enabling the board of directors to remove a fellow director who "fails to attend three consecutive meetings of the board without, in the opinion of the board, having a reasonable cause therefor or fails to perform any of the duties allotted to him as a member of the board".

4. The growth in size and in complexity of credit unions in Ontario has fostered an increasing need to rely on expert professional assistance and has led to an inevitable increase in the power and responsibility of the board of directors. It appeared to the Committee that the introduction of a general power to remove directors from office at any time would go some way to compensate for the consequent loss of member participation and of the democratic structure of credit unions by the continuing erosion of the tripartite structure of management and its replacement by professional assistants appointed by and responsible to the board of directors. Insofar as can be ascertained, only one provincial Act empowers the members in general meeting to remove a director before the expiration of his term of office.[2]

5. In its earlier Interim Report, this Committee recommended that the shareholders of a company have an unrestricted power to remove any director at any time by ordinary resolution in general meeting, and it appeared to this Committee that the considerations which led to its recommendation for the business corporation apply equally to credit unions.[3] The Committee recommends, therefore, that the members of a credit union be empowered to remove any director before the expiration of his term of office by ordinary resolution passed at a general meeting of the credit union. The notice of such meeting should specifically refer to the proposal to remove the director concerned to enable him to make such representations to the members regarding the resolution for his removal as he thinks fit.

6. The power of the members to remove a director (and as recommended in Chapters 15 and 16 a member of the credit committe or supervisory committee) by ordinary resolution at a general meeting depends for its effectiveness upon the ability of the members to ensure that such meeting will be convened. Section 48 of the Act provides that the Director may, upon the application of one-tenth of the members (or 100 where the membership exceeds 1000), call a special meeting of the credit union or direct the supervisor to conduct an examination of its affairs. The Committee concluded that the present provisions are unsatisfactory since there is currently no right in the membership to convene a special meeting of the credit union; should the Director accede to a request to call a special meeting he may require security for costs, and the requisitioning members will be reimbursed by the credit union only if the Director so directs. The

Committee recommends that a minimum of 5% of the members or 50 members, whichever is less, of a credit union be empowered to requisition the board of directors to convene a general meeting of the credit union for any purpose connected with the affairs of the credit union, not inconsistent with the Act, including the removal of a director, a member of the credit committee or supervisory committee. The board should be required to convene such meeting within 21 days after receipt of the written requisition of the members but should it fail or refuse to do so, the members should be empowered within 60 days to convene a general meeting and be reimbursed any reasonable expenses incurred unless a majority of the members at the general meeting vote against reimbursement.

7. The definition section of the Act defines officers to include "the treasurer, secretary, manager, assistant treasurer, assistant secretary, assistant manager and any employee who has authority to approve loans"[4] but not the president or the vice-president despite the fact that the Revised Standard By-laws provide for the election of a president and a vice-president. The Act, although it does not include president within the definition, provides that the president may be a member of the credit committee ex officio if the by-laws of a credit union so provide[5] and, in connection with the approval of by-laws by the supervisor, "two copies thereof, signed . . . by the president and the secretary, shall be sent to the supervisor".[6] The Committee recommends that the definition section of the Act be amended to define officers as meaning president, vice-president, treasurer, secretary, manager, assistant treasurer, assistant secretary, assistant manager and any employee who has authority to approve loans.

The Committee recommends that:

(a) the power to declare dividends and rebates of interest be vested in the board of directors;

(b) the Act should provide specifically for the right of a credit union to rebate loan interest;

(c) a director be subject to removal before the expiration of his term of office, by resolution of the members passed at a general meeting of the credit union;

(d) the notice of such meeting should specifically refer to the proposal to remove the director to enable him to make such representations to the members before and at the meeting as he deems fit;

(e) 5% of the members or 50 members, whichever is less, be empowered to convene a general meeting of the credit union in the manner set out in

paragraph 6 for any purpose connected with the affairs of the credit union not inconsistent with the Act, including the removal of a director or a member of the credit committee or supervisory committee; and

(f) officers be defined in the Act as meaning president, vice-president, treasurer, secretary, manager, assistant secretary, assistant manager and any employee who has authority to approve loans.

1. Section 30(1).
2. Saskatchewan Act, section 33.
3. Interim Report, 1967, Chapter VIII, Section 3.
4. Section 1(e).
5. Section 31(1); see also section 50(2).
6. Section 16(1).

CHAPTER 15

Internal Administration

The Credit Committee

1. Under section 31 of the Act the members at the first general meeting are required to elect from their membership a credit committe of "at least three members who shall not be members of the board of directors or the supervisory committee or officers of the credit union" to hold office for such period as the by-laws provide, but if they are elected in rotation their maximum term of office is three years. The Committee received no submissions respecting the election or tenure of the credit committee and our own consideration of this matter leads us to recommend no changes in the present provisions.

2. The Act is silent on the duties of the credit committee except to state that "it is the duty of the credit committee to consider all applications and approve all loans to members".[1] The Revised Standard By-laws do not elaborate upon the duties of the credit committee except to provide that "no approval of a loan shall be given by the credit committee unless a meeting of the credit committee unanimously consents to such approval". Unlike the supervisory committee, the credit committee is not obliged to submit a report to the annual meeting.

3. It was submitted to this Committee that the duties of the credit committee should be expanded to require all credit committees to keep minutes of meetings, to report monthly to the board of directors and to submit a written report to the annual meeting of the credit union. The Committee recognizes that the credit committee of many credit unions has already adopted as its standard procedure the additional duties suggested above, but considers that the credit committee of all credit unions should be required to operate in such manner. The Committee therefore recommends that the credit committee should be required to keep minutes of its meetings, to submit a written monthly report to the board setting out as a minimum the number of loan applications received, loans granted and security obtained, if any, and to submit a written report to the annual meeting of the credit union.

4. The Act permits the credit committee to delegate the power to make loans, but the restrictions upon such delegation are such as severely limit its utility. Section 31(7) of the Act provides:

> "The credit committee may upon such terms as it determines,
>
> (a) authorize the treasurer or manager, without obtaining its approval, to make loans in amounts not exceeding the shares and deposits of the borrower less any debts owing by him to the credit union; or

(b) authorize the treasurer, manager or other person, without obtaining its approval, to make loans in amounts not exceeding $100 for periods not exceeding three months."

The Committee considers that the above provision is too restrictive particularly in the light of other provincial legislation which does not generally distinguish between the independent authority of the treasurer or manager and any "other person" if all are acting as delegates of the credit committee. The Committee recommends that the section be amended to permit the credit committee acting by majority to authorize the treasurer, manager or other person to make loans to a maximum of the net savings of the member in the credit union plus such additional amount as is fully secured by the market value of Government of Canada or provincial bonds pledged as security or such additional amount as may be prescribed by Regulation where the loan is unsecured.

5. Although the provisions respecting the election and composition of the credit committee would appear at first sight to conform to the original idea of separate and independent membership, the rigid demarcation between the credit committee and the board of directors has been eroded in several respects. If the by-laws so provide, the president who is elected by the board from among its members may be a member of the credit committee ex officio. Vacancies occurring in the credit committee are filled by the board until the next annual meeting rather than by the credit committee. Similar provisions exist in other provincial Acts and perhaps the dilution of the principle of separate and independent membership is less in Ontario than in most other provinces. In Saskatchewan, for example, the board of directors appoint the whole of the credit committee and are themselves eligible for membership.[2] In New Brunswick, directors are eligible for election to the credit committee by the members but may not constitute a majority of the credit committee.[3] Only in Quebec and Manitoba does the legislation prohibit any member of the board of directors, the supervisory committee or any officer from serving on the credit committee.[4]

6. Of greater importance is the provision in section 31(8) of the Act whereby a credit union may, by by-law, authorize the board of directors to appoint one or more employees to perform all or some of the functions of the credit committee. A person so appointed is usually known as a loan officer. There are currently two by-laws for this purpose which the supervisor will approve. One by-law provides that the loan officer performs all of the duties of the credit committee which, being stripped of its functions, is generally not thereafter elected or if elected acts only in an advisory capacity. The other by-law provides that the loan officer has power to approve loans only up to a certain amount, with the approval of the credit committee required for loans in excess of the stated amount. A number of credit unions have enacted the by-law which, in effect, vests

all of the powers of the credit committee in a loan officer. In the case of larger credit unions, where there is a large demand for loans, it would appear that the credit committee may not be able to function effectively due to sheer volume and the interests of such credit unions are better served by professionally trained loan officers. If a loan officer is appointed with authority to approve all loans and not merely loans to a stated amount, there appears to be little point in requiring the credit union to elect a credit committee, which would serve little or no purpose. The Committee concluded that the present provisions with respect to the appointment of loan officers are satisfactory and recommends no change. It should be open to a credit union to appoint a loan officer with unlimited or limited power to approve loans and in the former case to dispense with the credit committee.

7. A recent amendment to the Act[5] prohibits credit unions from appointing the secretary, the treasurer, or manager of the credit union or his assistant as loan officers apparently on the basis that by preventing the officer or person normally entrusted by the board of directors with the power to disburse moneys of the credit union from authorizing a loan would protect the members against possible fraud. It was submitted to this Committee that this provision, which was enacted in 1966, has not worked well since it has prevented qualified persons from being in the position where they are needed most. The Committee considers that on balance the benefits of appointing as loan officer a person already conversant with the affairs of the credit union and the possible savings to a small credit union by such an appointment outweigh any risks of losses resulting from a fictitious loan "approved" by the loan officer and "made" in his dual capacity as secretary, treasurer or manager, which would in any case be diminished by proper bonding of the person concerned. The Committee accordingly recommends that section 31(8a) be deleted.

8. The Committee noted that for a reason not immediately discernible from the Act itself, there appears to be an unwarranted discrepancy in the provisions governing the credit committee and the supervisory committee. The Act provides that, if a member of the credit committee fails to attend three consecutive meetings of the committee without, in the opinion of the board of directors, having a reasonable cause therefor or fails to perform any of the duties allotted to him as a member of the committee, his position on the committee may be declared vacant by the board of directors.[6] However in the case of the similar provision dealing with the removal of members of the supervisory committee, the members of that committee and not the board of directors are given the right to declare the position vacant.[7] The Committee is of the opinion that the procedure in the case of each committee should be the same and that the members of the credit committee rather than the board of directors should have the right to declare vacancies in the circumstances set out in section 31(5). It should

also be the function of the credit committee and not the board of directors to determine if the circumstances exist which give rise to the right to declare a vacancy under section 31(5). The board of directors is responsible for filling casual vacancies on the credit committee until the next annual meeting whereas, in the case of the supervisory committee, a casual vacancy is filled by the remaining members of that committee. The Committee recommends that the power to fill vacancies on the credit committee between annual meetings be vested in the credit committee rather than in the board of directors. The Committee also recommends that the Act provide that the members of a credit union have the right to remove a member of the credit committee by ordinary resolution passed at a general meeting, subject to the same procedural requirements as those recommended by the Committee in the case of the removal of a director.

9. The Committee recommends that:
   (a) the credit committee be required to keep minutes of its meetings, to submit monthly reports to the board of directors concerning loan applications, loans approved and security taken, and to submit a written report to the annual meeting of the credit union;
   (b) the credit committee be empowered to delegate to the treasurer, manager or other person the independent power to approve loans not exceeding a member's shares and deposits, plus such amounts as are fully secured by the market value of Government of Canada or provincial bonds pledged as security, and unsecured loans up to a maximum amount prescribed by Regulation;
   (c) a credit union be empowered to appoint as loan officer, the secretary, treasurer or manager of a credit union or his assistant and that for this purpose section 31(8a) of the Act be repealed;
   (d) the credit committee and not the board of directors should have the right to determine if the circumstances exist which give rise to the right to declare a vacancy on the credit committee under section 31(5) and the credit committee and not the board of directors should be empowered to declare the vacancy under that section;
   (e) casual vacancies on the credit committee be filled by the remaining members of the credit committee and not by the board of directors as the Act presently provides; and
   (f) the members of the credit committee be subject to removal by resolution of the members in general meeting subject to the same procedural requirements recommended for the removal of directors of a credit union in Chapter 14.

1. Section 31(6).
2. Saskatchewan Act, section 31.
3. New Brunswick Act, section 11(4).
4. Quebec Act, section 60; Manitoba Act, section 59.
5. Section 31(8a), enacted in 1966.
6. Section 31 (5).
7. Section 32 (6).

CHAPTER 16

Internal Administration

The Supervisory Committee

1. The Act requires that every credit union at its first general meeting elect from among its members "a supervisory committee of three members".[1] In common with the majority of provincial Acts, the members of the supervisory committee may not be directors, members of the credit committee or officers. Like the credit committee, the members of the supervisory committee may hold office for such period as is prescribed in the by-laws of the particular credit union and if elections are subject to rotation the maximum term is three years. The Act requires that the credit committee consist of at least three members and the board of directors of at least five members and there seems to be no valid reason for restricting the size of the supervisory committee to three if the members wish to elect a larger supervisory committee and members are available to serve. Moreover, the limitation to three members can constitute a serious disadvantage to larger credit unions in view of the growing complexity of credit union finances resulting in increased responsibilities which cannot presently be shared among more than three persons. The Committee accordingly recommends that section 32(1) of the Act be amended to require the supervisory committee to consist of "at least three members".

2. The principal functions of the supervisory committee are to examine and audit the books and financial affairs of a credit union and generally to provide a degree of surveillance over its affairs and to ensure that they are conducted according to law. Section 32(7) of the Act sets out the duties of the supervisory committee as follows:

> "The supervisory committee shall from time to time examine and audit the books of the credit union and the deposit books of the members and shall check the cash, investments and securities of the credit union."

Neither the Act nor the Revised Standard By-laws further defines or elaborates upon the scope and manner in which these duties of the supervisory committee should be carried out and it would appear to this Committee that the lack of such definition constitutes a deficiency in the Act. After examination of other provincial legislation, which almost without exception defines the duties of the supervisory committee in greater detail than the Ontario Act, the Committee concluded that either the Act itself or Regulations should contain provisions to ensure that the procedures adopted by the supervisory committee constitute adequate surveillance

over the financial affairs of the credit union in accordance with the basic duties set out in section 32(7). The Committee concluded against recommending in detail the precise procedures to be adopted by all supervisory committees since this might be more effectively determined through consultation between the leagues and the Department. However, the Committee does recommend that in any event the supervisory committee should, in addition to the present requirement to submit a report to the annual meeting of the credit union, be required to meet at least bi-monthly, to keep minutes of its meeting and, if an auditor has not been appointed by a credit union, to conduct an examination and audit of the credit union's affairs at least quarterly, reporting thereon to the board of directors. The Committee recognizes that certain modifications even to this brief outline of suggested duties of the supervisory committee might perhaps be required to meet the situation where an auditor has been appointed.

3. There is some doubt as to the right of the supervisory committee to appoint an auditor to assist it in carrying out its duties. Section 32(13) gives the supervisory committee express power to appoint an auditor in the limited circumstances provided for in that section.

> "If a majority of the supervisory committee suspects that any of the funds, securities or other property of the credit union have been misappropriated or misdirected, the supervisory committee may, with the written approval of the supervisor, appoint an auditor or auditors to assist it in ascertaining whether any of the funds, securities or other property of the credit union have in fact been misappropriated or misdirected and the remuneration of any auditor or auditors so appointed shall be paid by the credit union."

It might be argued that there is a general power conferred on the supervisory committee to engage an auditor to assist it under section 32(14) of the Act which reads as follows:

> "The supervisory committee may appoint such persons as it deems necessary to assist it in performing its duties, and the remuneration to be paid to such persons shall be determined by the board of directors."

although the express power to appoint an auditor in the limited circumstances set out in section 32(13) may well supersede any general power under section 32(14).

4. The Committee recommends that the Act be amended to remove any doubt that the supervisory committee has a general power to appoint an auditor, as it deems fit under section 32(14), to assist it in its duties. In view of the fact that credit unions are financial institutions, it is always desirable, and perhaps necessary in some cases, that the benefit of the advice of an auditor be available to the supervisory committee. Accord-

ingly, the Committee recommends that section 32(14) be amended specifically to provide that the supervisory committee may appoint an auditor at any time to assist it and that the supervisory committee, rather than the board of directors, be given power to authorize the remuneration of such an auditor. The Committee also recommends that section 32(13) be amended to make it obligatory for the supervisory committee to appoint an auditor to assist it under the circumstances outlined in that section.

5. A provision in the Act somewhat similar to section 31(8) concerning the replacement of the credit committee by a loan officer permits a credit union to replace the supervisory committee with an auditor if a by-law to that effect is enacted. Under sections 32(11) and 32(15) certain of the functions of the supervisory committee are vested in the auditor and the remaining functions not entrusted to the auditor may be vested in the board of directors. The relevant provisions are as follows:

> "(11) A credit union may, by by-law, provide for the appointment of an auditor or auditors in lieu of or in addition to the supervisory committee and may delegate to such auditor or auditors the whole or such part of the duties of the supervisory committee as the by-law provides.
>
> (15) Where a credit union pursuant to subsection 11 has passed a by-law appointing an auditor or auditors to perform the duties of the supervisory committee set forth in subsections 7 and 10, the by-law may delegate the remaining powers and duties of the supervisory committee to the board of directors and provide that so long as the by-law remains in force it is not necessary to elect the supervisory committee as required by subsection 1."

As noted in Chapter 27, the Committee favours the appointment of a qualified auditor by all credit unions, since the benefit of professional advice is an additional safeguard for the savings of the members. Although the Committee is advised that the by-law adopted by most credit unions when appointing an auditor pursuant to section 32(11) provides for the retention of the supervisory committee, the Committee considers that this should not be at the option of the particular credit union and that the supervisory committee should be retained in any event. There are several reasons why this is desirable. This Committee in its earlier Interim Report recommended that in certain cases and for the reasons therein given, business corporations be required to appoint an audit committee of the board of directors.[2] It seems to the Committee that the supervisory committee can well serve as an audit committee and its continued existence for this purpose alone is justified. Moreover, the audit performed by a qualified external auditor while a valuable check on the financial affairs of a credit union may only be carried out on an annual basis and should not therefore be viewed as an adequate substitute for the continuous sur-

veillance of a supervisory committee familiar with the workings of a particular credit union especially if, as the Committee has earlier recommended, the supervisory committee be required to meet at least bi-monthly. Apart from providing a means for participation of the membership in credit union affairs, the continued existence of a supervisory committee after the appointment of an auditor serves valuable functions since, in addition to its prescribed duties of auditing and examining credit union books and financial affairs, the supervisory committee is vested with certain other duties and powers stemming from its central function as the guardian of credit union funds which would be nullified by the appointment of an auditor and the transfer of any remaining functions of the supervisory committee to the board of directors. One such additional function which, in the view of this Committee, itself justifies a requirement that a supervisory committee continue in existence after the appointment of an auditor, is contained in section 32(8) which provides:

> "In the event of any of the funds, securities or other property of the credit union being misappropriated or misdirected or in the event of any of the by-laws of the credit union being contravened by the board of directors or by the credit committee or by a member thereof or by an officer or employee engaged by the board of directors, the supervisory committee shall forthwith advise the supervisor in writing and shall call a general meeting of the credit union, and, pending the holding of the general meeting, the committee may suspend any member of the board of directors or credit committee or any officer or employee until the general meeting and may appoint a member of the credit union to perform the duties of the person so suspended."

6. It appears to this Committee that the supervisory committee should not be required to wait until a misappropriation or misdirection of credit union assets has definitely been established or is actually in the course of taking place, as would seem to be required by the wording of section 32(8). They should be empowered or perhaps required to act on their reasonable suspicion of any misappropriation or misdirection since their early action might prevent losses to credit union members. With respect to the procedure for the exercise of the powers and duties of the supervisory committee under section 32(8), the Committee recommends that, in addition to the present requirement of making a report to the supervisor of credit unions in the event of actual or suspected misappropriation of credit union assets, the report should also be made to the Stabilization Board referred to in Chapter 25. Since the Stabilization Board might ultimately be called upon to make good any losses to the members resulting from a misappropriation, it should be placed as soon as possible in a position where it can exercise its own powers including, as we have recommended, the appointment of an administrator to reduce or prevent further losses. Having made

a report to the supervisor and the Stabilization Board, the Committee does not consider that the supervisory committee should be required to convene a general meeting of the credit union except where it has exercised its powers of suspension or where there has been an actual misappropriation or misdirection of assets or where the supervisor or the Stabilization Board so direct.

7. Section 32(8) also requires the supervisory committee to make a report "in the event of any of the by-laws of the credit union being contravened by the board of directors or by the credit committee or by a member thereof, or by an officer or employee engaged by the board of directors". It appeared to this Committee that it was somewhat inconsistent to require the supervisory committee to act in the event of a breach of the by-laws but not in the event of a breach of any provision of the Act or the Regulations. This would appear to be an unwarranted lacuna in the Act and we recommend that the duty of the supervisory committee to act be extended to breaches of the Act and of the Regulations as well as of the by-laws.

8. A submission was made to the Committee criticizing the power of the supervisory committee under section 32(8) to suspend a director or member of the credit committee, officer or employee in the event of a misappropriation or misdirection of credit union assets and to appoint interim replacements. It was submitted that the function of the supervisory committee in this regard should be only to recommend suspension and that the power to suspend be vested in the board of directors. It appeared to the Committee that to vest the power to suspend a director in the board of directors might severely fetter if not nullify its exercise and that the power to suspend any director, member of the credit committee, officer or employee appointed by the board is one of the few remaining effective checks and balances between the supervisory committee, the board of directors and the credit committee which underlie traditional credit union organization of separate and autonomous committees. The Committee recommends that the power to suspend and to appoint interim replacements remain in the supervisory committee and be extended also to situations where misappropriations or misdirections of credit union assets are reasonably suspected.

9. There would appear at present to be little supervisory control over the supervisory committee imposed by the Act. Under section 32(6), provision is made for the removal, by the members of the supervisory committee, of a member of that committee if he fails to attend three consecutive meetings without, in the opinion of the board of directors, having a reasonable cause therefor or fails to perform any of the duties allotted to him as a member of the committee. As in the case of the removal of a

member of the credit committee under similar circumstances, the Committee recommends that the supervisory committee and not the board of directors should have the right to determine if the circumstances contemplated by section 32(6) exist. The supervisory committee has power under certain circumstances to suspend the directors, but the board of directors has no power to suspend a member of the supervisory committee. The Committee considered whether such a power should be vested in the board of directors.[3] The Committee concluded that, while there should be some provision in the Act to curb possible abuses and to remedy the deficiencies of inactive or inept members of the supervisory committee, particularly if the supervisory committee fails to act under section 32(6), such controls as might be recommended should not be vested in the board of directors. One of the most effective checks upon the board of directors is the power of the supervisory committee to suspend any director and this might be weakened if the board of directors were to have the power to suspend a member of the supervisory committee. The Committee recommends that, as in the case of directors and members of the credit committee, the Act provide that the members have the right to remove a member of the supervisory committee by ordinary resolution passed at a general meeting, subject to the same procedural requirements.

10. The Committee recommends that:

(a) the Act be amended to provide for a supervisory committee of at least three members;

(b) the duties of the supervisory committee be expanded in the Act to include requirements to submit a report to the annual meeting, to meet at least bi-monthly, to keep minutes of its meetings and, if an auditor has not been appointed by a credit union, to examine and audit the affairs of the credit union at least quarterly, reporting thereon to the board of directors;

(c) the supervisory committee be given a clear independent power to appoint an auditor to assist it and to authorize the remuneration of the auditor so appointed;

(d) that section 32(13) be amended to require the supervisory committee to appoint an auditor in the circumstances set out in that section;

(e) section 32(11) be amended to require the retention of the supervisory committee after the appointment of an auditor and that section 32(15) therefore be repealed;

(f) section 32(8) be amended to require the supervisory committee to act upon a reasonable suspicion of a misappropriation or misdirection of assets;

(g) section 32(8) be further amended to provide that in the circumstances outlined in that section the supervisory committee be required to advise both the supervisor and the Stabilization Board;

(h) section 32(8) be further amended to provide that the supervisory committee shall also advise both the supervisor and the Stabilization Board of breaches of the Act and of the Regulations;

(i) section 32(8) be further amended to provide that the supervisory committee shall not be required to convene a meeting of members unless it has exercised its power of suspension thereunder or there has been an actual misappropriation or misdirection of assets or the supervisor or the Stabilization Board direct that a meeting be convened;

(j) the present power of suspension conferred on the supervisory committee by section 32(8) be retained and extended to include a power to suspend for any misappropriation or misdirection of assets reasonably suspected;

(k) the supervisory committee and not the board of directors should have the right to determine if the circumstances exist which give rise to the right to declare a vacancy on the supervisory committee under section 32 (6); and

(l) the members of the supervisory committee be subject to removal by resolution of the members in general meeting subject to the same procedural requirements recommended for the removal of directors of a credit union in Chapter 14.

1. Section 32(1).
2. First Interim Report, Chapter X, Section 2.
3. As in the Prince Edward Island Act, section 19(3).

CHAPTER 17

Internal Administration

Standard of Care of Directors and Members of the Credit and Supervisory Committees

1. The Act contains no provision setting out the standard of care which a director or a member of the credit committee or supervisory committee is expected to exercise in the conduct of the affairs of the credit union. There would appear to be no reported cases in Canada in which the standard of care demanded of those involved in the administration of credit union affairs has been considered and the relevant legislation of other provinces is also silent in this regard. The directors and perhaps the members of the two committees of a credit union stand in a fiduciary relationship toward the credit union and therefore owe a duty to act honestly and in good faith. Since such persons as elected representatives of the membership are invested by statute with certain powers and duties and have certain responsibilities for the savings of other members placed with the credit union, it seems evident that they must also perform their duties with a degree of care, skill and diligence. The Committee therefore concluded that the directors and members of the credit and supervisory committees should be required to exercise a degree of care, skill and diligence measured by an objective standard in the conduct of their duties.

2. In the absence of any legislative or judicial guidelines, it is difficult to formulate with any degree of precision the standard of care, skill and diligence which, in the view of this Committee, should be required of members involved in the administration of the affairs of credit unions. The Committee concluded after deliberation of this problem that a standard of care, skill and diligence should be included in the Act and recommends that, so far as directors are concerned, the standard recommended by this Committee for the director of a business corporation in the first Interim Report in Chapter VII be made applicable to directors of credit unions. With respect to the standard of care, skill and diligence to be required of members of the credit committee and the supervisory committee, we recommend that the same basic standard applicable to credit union directors also apply to members of the credit committee and supervisory committee.

3. The Committee recognizes that the value of having a standard of care set out in the Act in the terms recommended above depends upon the means available to the membership for enforcing it. The present position of an action by a member on behalf of the credit union to enforce whatever duties might be owed under the common law would seem to be obscure,

and as far as can be established has hitherto remained academic. It appears possible that a minority shareholder's action might lie if illegal or ultra vires actions or a fraud on the minority can be alleged despite the special nature of credit union shares with the limit of one vote per member regardless of the number of shares held. The Committee recommends that a derivative right of action similar to that recommended for shareholders of a business corporation in the first Interim Report of this Committee in Chapter VII also be made available to credit union members who would thereby be enabled to enforce the standard of care recommended for directors and members of the credit committee and supervisory committee.

4. The Committee recommends that:

   (a) the standard of care, skill and diligence to be exercised by the director of a business corporation as recommended by the Committee in Section 2 of Chapter VII of its first Interim Report be made applicable to directors and members of the credit committee and supervisory committee of a credit union; and

   (b) a derivative right of action similar to that recommended for shareholders of a business corporation in Section 4 of Chapter VII of its first Interim Report be made available to members of a credit union.

CHAPTER 18

Internal Administration

Voting Rights

1. In keeping with the co-operative nature of a credit union, each member has only one vote regardless of the number of shares held and the use of proxies is generally prohibited. Section 24 of the Act provides as follows:

> "No member shall have more than one vote, and voting by proxy shall be allowed only when shares are held by an agricultural association, a municipal body, a school board, or other corporation."

2. The limitation of one vote per member ensures that, unlike an ordinary business corporation, a credit union cannot be controlled by members with large investments and the democratic value of this co-operative principle persists regardless of the size of the credit union. However, unlike the one vote per member principle, the value of a general prohibition on the use of proxies by individual members diminishes with the size of a credit union. In a small credit union operating in a restricted local area, the interdiction on the use of proxies might well encourage membership participation at meetings although even in smaller credit unions there must be a certain amount of member apathy. The larger the credit union, either terms of membership or in area served, the more difficult it becomes to engender member participation at meetings and there are undoubtedly many members of larger credit unions who do not attend meetings. In the case of a few credit unions which are organized with a province wide occupational bond many members cannot attend meetings either because of the distance or expense involved. Under these circumstances, to deny a member the power to vote by proxy may effectively deprive him of his vote and thereby from participating altogether in the affairs of a credit union. The non-attendance of members at meetings may become more pronounced if, as a result of the broadening of the membership bond, as the Committee has recommended, the trend is towards fewer but larger credit unions. It may be necessary at some time in the future to consider empowering credit unions to permit their members to vote by proxy or perhaps to establish some form of delegate voting as is presently permitted in the case of co-operative corporations under The Corporations Act.

3. In the view of this Committee, it would be premature to make specific recommendations at this time since the extent to which changes may be necessary and the means by which they can most effectively be accomplished might best be considered in the light of the experience of the credit union movement during the period of transition and growth of credit unions which may follow if the recommendations of this Committee are implemented.

CHAPTER 19

Loans

1. Section 4(1) of the Act sets out the objects and purposes of a credit union as:

"(a) the receiving of moneys on deposit from members and as payment for shares;

(b) the making of loans to members with or without security for provident and productive purposes."

In Ontario, most credit union loans are personal consumer loans although some credit unions, particularly those organized with an ethnic bond, have traditionally emphasized mortgage lending. The concentration on consumer loans provides another point of contrast with the caisses populaires which have traditionally favoured mortgage loans and which can probably be attributed to their separate historical development. However, the differences in the lending policy of a typical caisse populaire and a typical credit union are narrowing since caisses populaires are steadily increasing the proportion of loans made for personal consumption while many credit unions, particularly those in urban areas, are expanding their activities in mortgage loans.

2. There is no statutory limit on the proportion of credit union assets which may be invested in loans to members and the practical lending limits of a credit union in Ontario are usually determined firstly by the success of its educational program, promoted and arranged through the leagues, in persuading members to invest their savings in the credit union thereby providing funds available for lending to its members and, secondly, by the ability of a credit union to borrow, usually but not exclusively from a league central or OCCS. As noted in connection with our consideration of the borrowing powers of credit unions, the Act limits such outside borrowings to a maximum of 50% of the total of the capital, deposits and surplus of the credit union.

3. The Revised Standard By-laws, in a somewhat tortuous provision, regulate the amounts which may be available to individual members at any time by way of secured or unsecured loans, and provide as follows:

"(a) The total amount on loan to any member at any time shall not exceed five hundred dollars ($500.00) unless security therefor has been given.

(b) The total amount on loan to any member at any time shall not exceed $1,000.00 in excess of the member's savings, or 5% of the credit union's capital and deposits in excess of the member's savings, whichever is the greater.

(c) Unless secured by a first mortgage of real estate no loan shall be made in an amount which exceeds the member's saving by

(i) three thousand dollars ($3,000.00)
or

(ii) an amount equal to 2% of the total of the capital and deposits of the credit union, whichever is the greater, provided in any event that no loan shall be made in an amount which exceeds the member's savings by more than five thousand dollars ($5,000,00) unless so secured by a first mortgage of real estate; and

in no case shall the total amount on loan to any member at any time, exceed the member's savings by more than fifteen thousand dollars ($15,000.00)."

Since not all credit unions have enacted the Revised Standard By-laws, particularly those incorporated some time ago, there is some degree of variation between credit unions on the maximum amount of any loan. This may also occur where the supervisor approves a by-law providing for different limits.

4. Interest on loans is responsible for most of the profits of a credit union. The maximum rate of interest a credit union may charge is limited by statute to 1% per month[1] and, although the maximum rate appears to have become the normal rate for personal consumer loans at least, some credit unions give rebates of loan interest and almost all credit unions arrange life insurance for members on outstanding loan balances.

5. Although most loans by credit unions are consumer loans, there has been a growing tendency on the part of some credit unions towards increasing the number of mortgage loans which they make. Mortgage lending is undoubtedly a legitimate and valuable function of a credit union and one which is likely to increase in importance in the future. There are nevertheless certain risks associated with mortgage lending if too much is loaned on a particular piece of property for too long a period. The Department has also indicated its concern over possible adverse effects upon the general level of liquidity maintained by mortgage lending credit unions resulting from a reduction in the flow of repayments as assets are diverted from short term consumer loans to longer term mortgage loans.

6. The Department has unofficially limited the maximum but renewable term of a mortgage loan to five years and the maximum amount which may be loaned upon security of any property to 66⅔% of its appraised value. The Department has also recommended that a credit union limit its total investment in mortgage loans to 25% of its combined shares and deposits and has indicated that a higher level of liquidity is expected of credit unions which invest a substantial porportion of their funds in mort-

gage loans. The following scale relating the percentage of liquidity to the proportion of its assets invested in mortgage loans has been recommended by the Department as a guide to credit unions:

Mortgage Loans in aggregate expressed as a percentage of total assets	Corresponding liquidity required expressed as a percentage of members' shares and deposits
20%	20%
30%	25%
40%	30%
50%	35%

The Committee was advised that the Departmental recommendations respecting the maximum term for mortgage loans and the maximum amount to be advanced upon any property are widely accepted, but that a number of credit unions have not adopted the limits upon the proportion of their assets which may be invested in mortgage loans and the suggested adjustments in their liquidity in accordance with the scale referred to above.

7. We consider that the present Departmental limit of five years as an initial maximum term to be satisfactory but the limitation of an individual mortgage to 66⅔% of appraised value is too low and should be raised to 75%. However, if a credit union were to become an approved lender for the purpose of making loans under the National Housing Act, these limitations should not apply and such a credit union should be permitted to make mortgage loans under that Act within the limits provided therein. We recommend against the enactment of any limitation on the proportion of credit union assets which may be invested in mortgage loans or of a scale which would relate the general liquidity base to the proportion of credit union assets invested in mortgage loans since in our view these are makeshift measures designed to offset the shortcomings of the Act which does not contain any general minimum liquidity requirement for all credit unions. If, as is recommended by this Committee in Chapter 24, all credit unions should be required to maintain in liquid assets 10% of the total of shares, deposits and borrowings, there is in our view no basis for further limiting the proportion of shares and deposits a credit union may invest in mortgage loans or to require a corresponding increase in the minimum general level of liquidity.

8. Credit unions are limited by section 4 (1) (b) of the Act to making loans to members "for provident and productive purposes". There are no further qualifications to this phrase which is as old as the credit union movement and which for all practical purposes has for some time been interpreted to

include loans for such purposes as the board of directors, who are responsible for the lending policy of the credit union, may determine. In its original context, loans for provident and productive purposes would have excluded many personal consumer loans although such loans currently form a large proportion of the loans made by credit unions in Ontario today. The Committee considered whether it was desirable to retain in the Act a phrase limiting the approved purposes of credit union loans which has outworn its original meaning. It appears that every provincial Act except two contains a clause similar to section 4 (1) (b) although there is some variation as to whether loans must be for "provident and productive purposes" as in Ontario, or "for provident or productive purposes", or "for provident, productive and merchandizing purposes". The Acts of Quebec and British Columbia contain no reference to the purposes for which loans may be made. The limitation of loans to "provident or productive purposes" seems never to have been included in the Quebec legislation and this requirement was deleted from the British Columbia Act in 1961. The Committee has been advised that the applicant for a loan from a credit union is usually required to state in the loan application the purpose for which the loan is desired but it is doubtful if either the credit committee or the loan officer can effectively police the requirement. While the Committee does not wish to interfere with the policy of any credit union for the processing of loans, it does appear that the requirement that loans be made for "provident and productive purposes" may impose a condition that is impossible in some cases for credit unions to meet and the Committee therefore recommends the deletion of these words. If any credit union, as a matter of loan policy, wishes to maintain such a limitation, it would of course be free to do so.

9. The rate of interest a credit union may charge on loans to members is limited by statute in Ontario to 1% per month. A similar restriction exists in the Act or standard by-laws of each province except Quebec, where there is no restriction. The draft new Manitoba Act would limit the maximum rate of interest on loans to that prescribed by the Lieutenant-Governor in the standard by-laws. As previously noted, the maximum rate appears to have become the normal rate of interest, at least for personal consumer loans, but a large number of credit unions give rebates of interest and nearly all credit unions arrange life insurance for borrowers on the outstanding balance. With the high prevailing interest rates, credit unions are finding it more difficult to maintain a sufficient spread between the cost of borrowing money from members, or from outside sources, and the interest ceiling and the Committee received submissions urging that the interest ceiling be either raised or removed altogether from the Act.

10. Credit unions are, in our opinion, non-profit institutions one of whose principal aims is to provide credit services for members at the

lowest possible cost and we are, therefore, reluctant to recommend any change in the maximum interest rates which might encourage credit unions to charge more than is absolutely necessary to function in an effective manner. Although it might be argued, and in many cases it would be true, that an increase in interest rates would be offset where possible by increased rebates of loan interest, there is no requirement that interest rebates be made. To remove a limit on the permitted lending rate of credit unions might, in our view, favour poorly managed credit unions by enabling them to cover managerial inefficiencies by increasing their lending rates. On the other hand, we recognize that credit unions may suffer from a competitive disadvantage particularly under present economic conditions by not being able to offer members a return on their investment comparable with that offered by chartered banks and trust companies which are now permitted to adjust at will both their borrowing and lending rates. The Committee therefore recommends that the Act be amended to provide for an interest ceiling of 1% per month subject to such increase as may be prescribed by Regulation which will enable adjustments to be made as necessary to meet market conditions. A similar provision exists in British Columbia and in that province a Regulation, approved October 17, 1969, has provided for an increase in interest rates.[2]

11. Section 29(3) of the Act provides that a director, officer or member of either the credit committee or the supervisory committee may not borrow more than the amount of his paid up shares and deposits in the credit union unless the loan is approved not only by the credit committee but also by the supervisory committee and the board of directors. It was submitted to this Committee that this exceptional procedure be deleted since it was no longer necessary as a safeguard to prevent those responsible for the administration of the affairs of the credit union from making loans to themselves on a preferential basis and imposed an unnecessary indignity upon those persons subject to the provision. The Committee examined the equivalent provisions in other provincial legislation which in most cases require a special procedure for the authorization of loans in these circumstances substantially similar to that presently required under the Ontario Act. In Quebec, members of the credit committee and supervisory committee are not permitted to borrow from the credit union at all.[3] The Committee concluded that it would be undesirable to amend section 29(3) in accordance with the submission. As a general principle, dealings between those involved in the administration of a corporation's affairs and the corporation should be subject to close scrutiny and the procedure and conditions should be such as not only avoid any actual or potential conflict of interest but also the suspicion of any conflict or preferential treatment at the expense of the members. In this regard we would refer to our recommendations in Chapter VII of the first Interim Report concerning conditions under which contracts could be entered into between a director and a company. In a

credit union where the management is divided between the board and the credit and supervisory committees, the equivalent of approval by a disinterested board of directors of a business corporation would seem to this Committee to involve the approval of the three bodies responsible for administering the affairs of the credit union. Furthermore, it seems possible that, were the submission to be adopted, a conflict of interest might arise in those credit unions where a loan officer has been appointed since he is presently appointed by and responsible to the board of directors who might thus be placed in the extraordinary position of making loan applications qua members to a person who is appointed by and responsible to those members qua directors. We consider that such a result would be embarrassing to both the members of the board of directors and the loan officer and could result in a genuine conflict of interest.

12. The Committee recommends that:

(a) the present practice of limiting the maximum amount of any loan by by-law rather than by a provision in the Act should be continued since this permits a maximum of flexibility throughout the entire movement;

(b) the Act provide that the maximum term of any mortgage be five years, subject to renewal, and that the maximum amount which may be loaned by way of mortgage, in addition to any limitation in the by-laws of a credit union on the maximum amount of any loan, not exceed 75% of the appraised value of the property mortgaged;

(c) if a credit union becomes an approved lender for the purpose of making loans under the National Housing Act, it should be permitted to make loans under that Act within the limits provided therein;

(d) no additional liquidity requirement, other than that recommended in Chapter 24, be imposed in respect of mortgage loans;

(e) the Act not restrict the aggregate amount of mortgage loans of a credit union to a certain percentage of its assets;

(f) section 4(1)(b) be amended by deleting the phrase "for provident and productive purposes";

(g) the present limitation on the rate of interest which may be charged be retained subject to increase by Regulation; and

(g) there be no change in the provisions of section 29(3) of the Act.

1. Section 29(2).
2. B.C. Reg. 265/69, approved October 17, 1969.
3. Quebec Act, sections 57 and 64.

CHAPTER 20

Borrowing Powers

1. Section 36 of the Act provides:

> "The board of directors of a credit union may pass resolutions for borrowing money, but at no time shall the total amount borrowed exceed 50 per cent of its capital, deposits and surplus."

Under section 38, any borrowing up to 25% of the total of capital, deposits and surplus is within the discretion of the board of directors, but borrowing in excess of this amount requires the confirmation of two-thirds of the members present at a special general meeting, the notice of which must include the terms of the proposed resolution, or their unanimous approval if no meeting is convened. A confirmation by the members of such a resolution may not be given for a term exceeding one year. No submissions have been made to the Committee which indicate that the borrowing base is either inadequate or too large and the Committee does not recommend that any change be made in the borrowing base.

2. The limitations in section 36 of the Act on the right of a credit union to borrow apply to outside borrowings since, by reason of section 37, moneys received on deposit from members are not considered as borrowings. The Act does not contain a definition of the term "deposits" and it may not be entirely clear if "term deposits" would be considered as deposits within the meaning of section 37 or as borrowings by the credit union subject to the overall limitation.

3. The limitation on borrowing contained in section 36 was undoubtedly designed to prevent credit unions from over extending by disproportionate borrowing. If term deposits are deposits for the purposes of section 36, a credit union will be able to borrow more since such term deposits will swell the total of shares, deposits and surplus which form the yardstick of the borrowing power. If they are not classed as deposits, the borrowing base of a credit union is proportionately reduced. The Committee was advised that the Department classifies term deposits as deposits for the purpose of section 36 on the basis that term deposits may be accepted only from members and to that extent they constitute members' savings. In addition, all interest payable on term deposits is distributed within the membership group, whereas borrowings are from persons or institutions outside the membership. A different view has been taken in Manitoba where term deposits are excluded from the borrowing base.

4. The Committee agrees with the reasoning adopted by the Department and recommends that the Act be clarified by including in the definition

section a definition of deposits which would specifically include term deposits. The Committee is also of the view that, once the members have confirmed a resolution to authorize borrowings in excess of 25% of capital, deposits and surplus, no yearly confirmation should be necessary, but the members should have the right at an annual or special general meeting to revoke any resolution previously confirmed.

CHAPTER 21

Term Deposits

1. There has been an increasing tendency on the part of some credit unions to accept term deposits at fixed rates of interest from members. This may be in some part a response to increased competition which credit unions are probably experiencing from chartered banks, loan and trust corporations and other financial institutions for the savings of members. Although only a relatively small number of credit unions in Ontario presently offer their members this particular service, there is a likely trend towards increased acceptance of term deposits as a standard service and this has caused some concern among various provincial authorities.

2. To some degree, the acceptance of a deposit for a fixed term at a guaranteed rate of interest by any financial institution involves a risk that the prevailing interest rate at the date of acceptance of the deposit may decrease during the term of the deposit making it an expensive means of borrowing money. In the case of credit unions, however, term deposits may pose special problems not experienced by other financial institutions.

3. The maximum rate of interest a credit union may charge its borrowers is presently limited by statute to 1% per month. Chartered banks and loan and trust companies are not subject to any interest ceiling on their lending rate and may ensure that a sufficient interest spread is maintained between the cost of borrowing money by means of term deposits and the rate at which they lend money to operate at a profit. In order to compete, credit unions are in the position of having to offer their members interest rates on term deposits equivalent to those offered by chartered banks and loan and trust companies but are limited in the rate they may charge on loans made with money borrowed by means of term deposits. In times of high interest rates, a lending rate of 1% per month may be too low to enable a credit union to convert term deposits to profitable use. Yet, if a credit union is not permitted to match interest rates offered by other institutions it may encounter difficulty in attracting funds.

4. Term deposits require a high degree of managerial skill in order that the funds received may be profitably invested during the currency of the term and that the principal and interest will be available for repayment, particularly if the principal may be withdrawn before maturity subject to an interest penalty. Credit unions for the most part, as local co-operative institutions intended to be managed by the members, may lack both the experience and competence of other financial institutions in accepting term deposits and yet because of the interest ceiling on the lending rate may have to work with a lower spread.

5. In addition to problems in attracting funds in competition with banks and loan and trust companies and managing term deposits so as to produce a profit with what might well be a smaller spread and ensuring the availability of principal and interest upon maturity, acceptance on a large scale of term deposits at high rates of interests may seriously affect the financial stability of a credit union by reducing the net profits of the credit union from which the annual appropriation to the guarantee fund is made, since in computing such profits a deduction is first made for interest paid on deposits. From a financial viewpoint, it is undesirable that the adequacy of credit union reserves be unduly lowered by the expense of interest in attracting term deposits. From a philosophical viewpoint, it may also appear questionable in principle whether members should receive a reduced dividend in order to pay higher rates of interests on term deposits.

6. The concern of the Department over the possible effects of term deposits on the financial stability of a credit union resulted in an amendment to the Act by the enactment of section 28a which came into force on July 1, 1967. This section provides:

> "28a. A credit union may by by-law provide for accepting moneys for deposit in respect of which a specified rate of interest is payable only if the deposit is not withdrawn for a fixed term, and the credit union shall set aside a reserve fund, adjusted annually, in the amount of the interest accruing on such deposits."

By permitting credit unions to accept term deposits only if authorized by by-law, the Department can ensure through the discretionary approval of the supervisor needed as a prerequisite to the validity of the by-law that only those credit unions which in the opinion of the Department are competent to manage term deposits would be permitted to offer this service to their members. Moreover, the term of the deposit is also regulated since the by-law which the supervisor will approve must limit the maximum term to five years, which the Committee understands is not renewable.

7. The Committee was advised that the intended effect of the amendment was also to require credit unions to create and maintain a sinking fund for the principal and accrued interest on outstanding term deposits so as to ensure the existence of an adequate readily realizable fund for repayment of the term deposit upon maturity. In the view of this Committee, section 28a does not implement that intention. In fact, it is difficult to ascertain precisely what this section accomplishes.

8. Although the matter is not entirely free from doubt, it would appear that section 28a authorizes both term deposits which are withdrawable before maturity subject to an interest penalty and non-withdrawable term deposits but that only the latter are made subject to the reserve requirements contained in the section. The Committee is advised that this is the interpretation adopted by the Department. However, since nearly all term

deposits accepted by credit unions are of the kind withdrawable before maturity subject to an interest penalty, the provision for a reserve requirement in section 28a is of very limited application.

9. For the small number of non-withdrawable term deposits it does regulate, section 28a requires that a "reserve fund adjusted annually, in the amount of interest accruing on such deposits" shall be maintained. There is no requirement to place into a reserve each year a proportion of the principal or that the reserve be maintained as a separate fund. It is therefore conceivable that a credit union could invest the whole of its accumulated reserve for term deposits in further loans to its members.

10. The Department is concerned over the lack of an effective requirement for a reserve of principal and interest maintained in liquid investments as was intended when the amendment to the Act to regulate term deposits was proposed. As a matter of practice, therefore, the Department requires as a condition to granting the discretionary approval of the by-law required under section 28a, a written undertaking from the credit union to maintain a reserve of principal and interest in liquid investments which as defined by the Department include deposits in OCUL. This Departmental requirement, which is of questionable legal validity, is imposed only for non-withdrawable term deposits since it is not possible to set up a reserve of principal and interest for term deposits which may be withdrawable before maturity. It would appear then that the present position in Ontario is that withdrawable term deposits are not subject to any controls except the limit of the term of five years, while the isolated instances of non-withdrawable term deposits are subject to a limited and perhaps unworkable reserve requirement under section 28a implemented by an extra-legal Departmental requirement to correct the deficiencies of the section by means of an undertaking.

11. There is no uniformity among other provincial legislation regulating term deposits. In Saskatchewan, which on November 15, 1969 repealed certain restrictions relating to term deposits, the amount a credit union may accept in term deposits is limited to the total of its shares and deposits and the term is limited to a maximum of five years, non-renewable.[1] In British Columbia, there is a limit of six percent on the maximum rate payable on term deposits unless the Inspector permits a higher rate.[2] In Manitoba, term deposits have been excluded as deposits from the borrowing base.[3] In Manitoba, Saskatchewan and British Columbia, term deposits are subject to the statutory liquidity requirement imposed upon credit unions in those provinces.[4]

12. If the credit union movement is not to decline in Ontario, it must be enabled to complete effectively with other financial institutions. As already

noted, prompted perhaps by the effects of increased competition, credit union members today demand an increasing variety of services, and the future development of the credit union depends upon its ability to offer the members the services available in competing financial institutions. On the other hand, it is of overriding importance that the expansion of services should not jeopardize the investments of members and it is important that the stability of a credit union is not endangered by the added risks which unregulated acceptance of term deposits might well involve.

13. It appears to the Committee that an important area of control is to ensure that only those credit unions with proven competent management should be permitted to accept term deposits. Since this is not necessarily related to the size of a credit union, we consider the present requirement of an enabling by-law for this purpose, which requires the approval of the supervisor before it is effective, to provide a suitable means of limiting the power to accept term deposits to those credit unions regarded as competent to do so. No submissions have been made to the Committee to the effect that this present requirement of the Act be changed. The Committee is also of the view that no maximum interest rate in respect of term deposits be provided in the Act. In the view of the Committee, a credit union must be in a position to compete for the savings of its members and it is possible that a maximum interest rate fixed by statute or regulation would be too inflexible to respond to market conditions. We realize, however, that in permitting credit unions to determine the maximum rate of interest they can offer without affecting either the profitability of the particular service, or the dividends payable to members, places a considerable responsibility upon the management of a credit union. There should be a limit on the maximum term of a term deposit and the present administrative limit of a five year non-renewable term appears to be suitable.

14. We have recommended in Chapter 24 that a general liquidity factor of 10% of shares, deposits and borrowings be imposed on all credit unions and, since the Department, rightly in our view, classifies term deposits as deposits, term deposits should be included in the general liquidity requirement. The Committee considered whether a distinction should be made for liquidity purposes between term deposits which are withdrawable before maturity subject to an interest penalty and the so-called non-withdrawable term deposits. It seems likely, however, that even in the latter case a credit union in the interests of good relations among its members might very well permit the withdrawal of the so-called non-withdrawable term deposit before maturity. No other province which includes term deposits in liquidity requirements draws such a distinction and in the opinion of the Committee it is inadvisable to do so in Ontario.

15. The Committee recommends that:

(a) credit unions, if authorized by by-law, be permitted to accept term deposits from members;

(b) the Act specify no maximum interest rate payable in respect of term deposits;

(c) the Act provide that the maximum term of a term deposit be five years, non-renewable;

(d) term deposits be included as deposits for the purposes of the liquidity requirements recommended by the Committee in Chapter 24; and

(e) the portion of section 28a relating to a reserve in respect of interest on term deposits be repealed as serving, in practice, no useful purpose.

1. Saskatchewan Standard By-Laws, articles 76(a) to 76(m), as amended by O.C. 1417/68 and O.C. 1706/69.
2. B.C. Reg. 2/69, Rule 5.01.
3. Manitoba Act, section 41.
4. Ibid., section 57A.
   Saskatchewan Act, section 85(1).
   British Columbia Act, section 34(1).

CHAPTER 22

Financial Stability

General

1. The financial stability of credit unions is a matter of importance not only to the members but in the public interest. The acceptance by a credit union of moneys from its members, either by way of deposits or as payment for shares, imposes a responsibility on the credit union to protect such funds against losses and to meet the demands of members, when made, for the withdrawal of funds. The financial soundness of credit unions depends upon a number of factors such as adequate reserves, liquidity, external audit, supervision and a stabilization or mutual aid fund.

2. All provincial legislation contains, to a greater or lesser degree, provisions which are designed to promote or ensure the financial soundness of credit unions. All legislation provides that a credit union must, before any division of profit among members by way of dividend or rebate of interest, set aside a reserve against uncollectible loans. Some legislation requires that credit unions maintain a certain percentage of assets in liquid form. In all provinces, either by legislation or as a result of practice, credit union affairs are subject to external examination. A number of provinces have required credit unions of a certain size to appoint auditors. Some provinces require credit unions to contribute to a mandatory stabilization or mutual aid fund which is in effect a form of insurance designed to protect members of credit unions against loss.

3. The various matters relating to the financial stability of credit unions are examined in greater detail in the following Chapters 23 to 27.

CHAPTER 23

Financial Stability
The Guarantee or Reserve Fund

1. Section 28 of the Act requires every credit union to set aside at least 20% of its yearly net profits as a guarantee fund to meet losses and the fund is to be held as a reserve against uncollectible loans and losses. The section also provides that, where at the close of any fiscal year the amount set aside for the guarantee fund equals at least 10% of the total amount received from members on deposit and as payment for shares, the directors may, subject to the approval of two-thirds of the members present at the annual meeting, direct that no moneys be set aside for the guarantee fund for the then current year. In the case of a credit union whose combined share capital and deposits exceed $500,000 and whose guarantee fund equals at least 5% of the total amount received from members on deposit and as payment for shares, the directors may, with the approval in writing of the Director and with the approval of two-thirds of the members present at an annual or special meeting, direct that no moneys or that a sum less than 20% of yearly net profits be set aside for the guarantee fund. Any approval so given by the Director may be revoked at any time.

2. While the stated purpose of the guarantee fund is to act as a reserve against uncollectible loans and losses, the Departmental practice is to permit the guarantee fund to be used solely as a reserve against bad and doubtful debts. Any other loss experienced by a credit union, for instance on the sale of investments, would under this practice have to be met from operating revenues for the year rather than charged to the reserve.

3. A credit union, being a co-operative, distributes its yearly net profit to its members either in the form of dividends on shares or by way of rebate of interest paid by members on loans. If all of the yearly net profit was so distributed, without an adequate provision for uncollectible loans and losses, it is apparent that members' shares and deposits would be impaired in the event of uncollectible loans or other losses. A proper allowance for bad and doubtful debts is essential.

4. The Committee is concerned that an allowance for uncollectible loans measured by a percentage of either net or gross profit is not an appropriate yardstick to produce a proper allowance. An allowance founded on this basis could be too high in some cases and too low in others dependent upon the collectibility of the loans made by the credit union. Generally accepted accounting practice requires, in determining the financial position of any organization at a given date, that judgment be exercised which will give due recognition to bad and doubtful debts and that those debts which have become bad or doubtful should either be written off or provided for. The charge in respect of such bad and doubtful debts is generally regarded as a

cost of earning income. Accordingly, the net profit of the organization is arrived at after making due provision for bad and doubtful debts.

5. The Committee has concluded that the present basis of providing for the guarantee or reserve fund in section 28 should be changed from a fixed percentage of yearly net profit to one which will reflect a proper allowance for bad and doubtful loans. Normally, the determination of the amount to be written off for bad debts and the allowance for doubtful debts is a function of management with the assistance or approval of the auditors. While management of a credit union should not be relieved of this obligation it is recognized that, in the case of a great many credit unions, management may not be sophisticated in this area and auditors may not have been appointed. It therefore seemed desirable that the Act include minimum provisions with respect to the valuation of loans. Such provisions, of necessity, must be arbitrary and, after careful consideration, the Committee is of the opinion that the provisions of the Co-operative Credit Associations Act[1] in this respect offer a fair guideline to the method by which loans should be valued and the reserve or guarantee fund established.

6. The Committee accordingly recommends that in determining the financial position of a credit union management shall make proper provision for bad and doubtful accounts and that, in any event, in respect of any loan made by a credit union that is in default as to principal or interest there should be an allowance based on the following formula:

(a) where the loan is in default as to principal or interest for a period of three months but less than six months, ten per cent of principal, interest due and recorded accrued interest;

(b) where the loan is in default as to principal or interest for a period of six months but less than twelve months, twenty-five per cent of principal, interest due and recorded accrued interest;

(c) where the loan is in default as to principal or interest for a period of twelve months but less than eighteen months, fifty per cent of principal, interest due and recorded accrued interest;

(d) where the loan is in default as to principal or interest for a period of eighteen months but less than twenty-four months, seventy-five per cent of principal, interest due and recorded accrued interest; and

(e) where the loan is in default as to principal or interest for a period of twenty-four months or more, one hundred per cent of principal, interest due and recorded accrued interest.

The Credit Unions Act of British Columbia[2] requires a reduction in the value of loans computed on the same basis. The standard by-laws under the Alberta Act also base the reserve fund on an aging of loans. The latest draft of the proposed new Manitoba Act provides that the amount to be set aside for the reserve fund be based on the aging of loans.

7. The Committee also recommends that the amount of the allowance, based on the valuation of loans, should be shown as a separate amount rather than including the value of loans in the balance sheet at a net figure after allowance for bad and doubtful loans. The amount of the annual provision should also be shown separately each year in the statement of profit and loss as an operating charge. The members of the credit union will then be able to form a reasonable assessment as to the efficiency of management and the soundness of its policies in making loans.

8. The Committee also considered whether or not a contingency reserve was required after making provision for bad and doubtful debts to guard against other possible losses which a credit union might experience. Credit unions in the opinion of the Committee have an obligation to members to protect the deposits made by members and the amount which has been paid by members as payment for shares against any impairment in value. In view of the position of the members as depositors and shareholders and as a further measure of protection to them, the Committee recommends that there should be an additional general contingency reserve to ensure that all profits of the credit union are not paid out to members leaving no reserve against other losses. If an adequate provision is made for bad and doubtful debts the amount of the general contingency reserve need not be great. The Committee therefore recommends that, in addition to the allowance for bad and doubtful debts, each credit union be required in each year by way of a general contingency reserve to set aside an amount equal to a stated percentage of its yearly net profits until the general contingency reserve has reached an amount equal to a stated percentage of the assets of the credit union at risk, i.e., loans and investments. It would appear to the Committee that a percentage in the area of 5% of yearly net profits and 1% of assets at risk might be adequate.

9. The Committee recommends that:

(a) section 28 of the Act be repealed and replaced by a section which will require management of a credit union to make proper provision for bad and doubtful accounts and, in any event to provide an allowance in respect of loans in default as to principal or interest in accordance with the formula set out in paragraph 6 of this Chapter; and

(b) each credit union, in addition to the allowance for bad and doubtful debts, be required in each year to set aside, by way of general contingency reserve, an amount equal to a stated percentage of its yearly net profits until such reserve equals a stated percentage of its assets as risk.

1. S.C. 1952-53, c.28, section 51.
2. British Columbia Act, section 34(5).

CHAPTER 24

Financial Stability
Liquidity

1. As has been noted earlier, a credit union receives money from members either by way of deposit or in payment for shares. Unlike the shares of the business corporation, the shares of a credit union are withdrawable at any time at the request of the member. They are, in effect, simply another form of deposit. While a credit union may, under its by-laws, impose a notice period before shares and deposits (other than those subject to withdrawal by negotiable orders) may be withdrawn, in practice, this right is not exercised and deposits and shares are withdrawable on demand. It is essential, therefore, that a credit union maintain sufficient assets in cash or "near" cash form to meet the demands which may be made upon it for withdrawals of both deposits and shares. "Liquidity", or the ability to provide cash when it is required, is an important element in the financial soundness of credit unions. Lack of liquidity could react against a credit union's soundness if the need to raise cash in a difficult period required the sale of investments or the discounting of loans involving losses larger than the reserve fund.

2. Many local credit unions entrust either their league centrals or OCCS with their surplus cash either by way of deposit or, in the case of league centrals, through the purchase of shares. League centrals and OCCS in turn lend to other credit unions (and co-operatives, in the case of OCCS) which are in need of cash. League centrals and OCCS, in effect, act as bankers to a large part of the credit union movement through their ability to move cash from cash surplus credit unions to credit unions requiring cash. In view of the fact deposits with and shares of a league and ordinary deposits with OCCS are generally withdrawable on demand, the liquid strength of centrals and OCCS is an important factor in the overall stability of the credit union movement.

3. Except for credit unions which permit the withdrawal of deposits by use of negotiable orders, there is no requirement in the Act that requires a credit union or any of the leagues to maintain any portion of assets in liquid form. In the case of credit unions which permit members to withdraw deposits by use of negotiable orders, section 27a provides that such a credit union shall not make any loan and shall not invest its funds otherwise than in government securities and municipal securities if the aggregate of:

(a) its cash on hand or on deposit in chartered banks, the Province of Ontario Savings Office, trust companies, leagues under the Act, or co-operative credit societies subject to the Co-operative Credit Associations Act (Canada); and

(b) the face value of its investments in bonds and debentures of or guaranteed by the Government of Canada or any province thereof or by a municipal corporation in Canada, excluding any such investments that are pledged as security for money borrowed by the credit union

is less than 20% of the amount of money deposited with the credit union that is withdrawable by negotiable order. This requirement is not, strictly speaking, a liquidity requirement. It does not require a credit union to maintain a certain percentage of assets of the prescribed class but merely prohibits the credit union from taking certain actions if the required percentage is not maintained. The Act also permits a contemplated liquidity to be met by deposits in a league despite the fact that leagues are not subject to any overall liquidity requirement.

4. Although there is no mandatory liquidity requirement in the Act (except to the extent the provisions in respect of deposits subject to withdrawal by negotiable order can be said to be a liquidity requirement) the Director seeks, by persuasion, to require credit unions to maintain in cash or in assets quickly convertible into cash at least 10% of the amount of deposits and paid up shares. In the view of the Director, a higher percentage of liquidity is required in the case of those credit unions which have invested in mortgage loans to members.

5. The Royal Commission on Banking and Finance in its chapter on credit unions and caisses populaires expressed concern at the low level of liquidity which it found existed in the credit union movement in various parts of the country. The credit union administrators of various provinces at meetings of such administrators have also devoted much time to the question of liquidity. This Committee is equally concerned that both credit unions and centrals maintain a sufficient degree of liquidity to meet the foreseeable requirements of members for the withdrawal of deposits and shares.

6. The principal deposit taking institutions in Ontario are subject to mandatory liquidity requirements. Section 84 of The Loan and Trusts Corporations Act,[1] provides that every trust company shall at all times maintain:

(a) cash on hand or on deposit in a chartered bank;

(b) unencumbered debentures, bonds, stocks or other securities of or guaranteed by the Government of Canada or of or guaranteed by any province of Canada or of any municipal corporation in Ontario or city in Canada;

(c) loans payable on demand and fully secured by a class of security referred to in clause b; and

(d) subject to the approval of the Registrar (of Loan and Trust Corporations) and to such conditions as the Registrar imposes, a credit from chartered banks in Canada

to an aggregate of at least 20% of the amount of deposits and of funds received for guaranteed investment coming due in less than 100 days. Provision is also made in that Act for the percentage of each class of eligible assets that must be maintained. A substantially similar requirement is applicable to loan corporations (some of which accept deposits) under section 74 of the Act. Under the Bank Act,[2] each bank is required to maintain, as a primary reserve, a cash reserve in the form of notes of and deposits in Canadian currency with the Bank of Canada which shall be not less on the average during any month than an amount equal to 12% of deposit liabilities payable on demand in Canadian currency and 4% of deposit liabilities payable, after notice, in Canadian currency. Banks must also maintain a secondary reserve in addition to the cash reserve, if so required by the Bank of Canada.

7. The majority of other provinces require credit unions to maintain a percentage of deposits and shares in "liquid" form although the percentage and the type of assets which are considered to be liquid vary. In Alberta, credit unions must maintain 5% of shares, 25% of deposits subject to withdrawal by negotiable orders and 10% of other deposits in cash or readily convertible investments.[3] The requirements in New Brunswick are substantially the same as in Alberta.[4] Newfoundland requires credit unions to have at all times on deposit with a bank or a person acting or carrying on the business of banking approved for the purpose by the Registrar, at least 5% of its share capital and 25% of all its deposits.[5] Credit unions in Saskatchewan must maintain in cash or on deposit with a chartered bank or the Saskatchewan Co-operative Credit Society Limited 10% of shares and deposits and if such a credit union permits withdrawal of deposits by negotiable order it must also maintain, with respect to such deposits, cash on hand or in a chartered bank or in the Saskatchewan Co-operative Credit Society Limited or certain eligible investments 20% of deposits so subject to withdrawal up to $1,000,000 and 15% of such deposits in excess of $1,000,000.[6] In Manitoba, a credit union must maintain a cash or liquid reserve of not less than 5% of the total of the shares, deposits and borrowings of the credit union which is to consist of cash on hand or in a chartered bank, shares and deposits in a central credit union, or bonds which are authorized investments for trust funds. A credit union that permits the withdrawal of deposits by negotiable orders must also maintain a cash or liquid reserve of 10% of such deposits up to $1,000,000 and 8% of such deposits in excess of $1,000,000.[7] Manitoba is currently contemplating a new act which, if enacted in its present draft form, would have the effect of increasing the cash or liquid reserve to 10% of shares, savings accounts, deposits, term deposits and borrowings, and

in the case of deposits subject to withdrawal by negotiable order an additional cash or liquid reserve of 10% of such deposits up to $1,000,000 and 8% of such deposits in excess of $1,000,000. British Columbia has recently changed its liquidity requirement which now requires a credit union to maintain in certain deposits and investments an amount not less than 10% of the aggregate of its net share capital, deposits and borrowings or such greater percentage, not exceeding 12%, as the Lieutenant-Governor in Council may order, with the power to the British Columbia Credit Union Reserve Board to reduce the percentage in the case of any particular credit union on application to not less than 8%.[8]

8. In the view of the Committee, it is essential that credit unions maintain sufficient assets in cash or near cash form to meet the expected demands for withdrawal of deposits and shares. There seems little doubt that a great many credit unions recognize the need for a certain degree of liquidity and do in fact retain a percentage of assets in cash or near cash form. There was no evidence presented to the Committee that credit unions, on the whole, have not been able to meet the reasonable demands of members for withdrawals due to a lack of liquidity. However, liquidity is of such basic importance that the Committee feels that a minimum liquidity requirement should be mandatory. The present situation in which the Act contains no general liquidity requirement and where the Director seeks to obtain liquidity in credit unions as a matter of persuasion is not satisfactory.

9. The statistics furnished to the Committee by the Department of Financial and Commercial Affairs with respect to the operations of those credit unions reporting to the Department (and 262 out of 1,650 credit unions have not reported for the year 1968) show on a consolidated basis, at December 31, 1968, cash of $27,960,000 and investments of approximately $72,000,000 and shares and deposits of approximately $590,000,000. On the assumption that the investments are of a type which would be eligible for liquidity purposes, the liquidity ratio on a consolidated basis of reporting credit unions was approximately 17%. The breakdown of the statistics into the various groups of credit unions indicates the following liquidity ratios on a consolidated basis within the groups, again assuming the eligibility of all investments for liquidity purposes:

Industrial and Commercial Credit Unions	10.4%
Public Service Credit Unions	12.5%
Association Urban Credit Unions	22.4%
Association Rural Credit Unions	25.3%
Religious Urban Credit Unions	34.6%
Religious Rural Credit Unions	29.6%
Community Urban Credit Unions	17.4%
Community Rural Credit Unions	14.1%

Industrial and commercial credit unions and public service credit unions account for approximately two-thirds of the total assets of all reporting credit unions. It must be assumed, within the various groups of credit unions, that there are those which are above the average and others below.

10. It would appear that the minimum level of liquidity maintained by any group of credit unions is approximately 10% and this in the view of the Committee is the minimum level that should be required consistent with the desire to afford a reasonable measure of protection to members and at the same time not to divert an excessive percentage of the assets of the credit union for purposes other than the primary purpose of making loans to members at reasonable rates.

11. The Committee is also of the view that not only should shares and deposits be covered by liquidity requirements but that outside borrowings should also be included. The Manitoba Act has for some time extended the liquidity requirement in that province to cover borrowings. A recent amendment to the British Columbia Act now requires credit unions in that province to cover borrowings as part of the liquidity requirement. There appears to be very little difference between a borrowing by a credit union from its bankers or a central and a "borrowing" from a member by way of deposit or in payment for shares. Borrowings from chartered banks and OCCS are normally repayable on demand, just as "borrowings" from members by way of deposits or shares are withdrawable on demand. The total amount a credit union may borrow from outside the membership for all purposes, including liquidity, is limited to 50% of its paid up capital deposits and surplus, and as borrowings increase so the ability of a credit union to raise cash for liquidity by means of further borrowings decreases. Holding 10% of borrowings in liquidity is, therefore, a measure of protection to credit unions.

12. The leagues, in the operation of their centrals, and OCCS, by and large act as the "bankers" to many of the credit unions. As has been noted, centrals and OCCS act as the instrument which facilitates the transfer of cash from cash surplus credit unions to credit unions in need of cash. It seems apparent, in view of the function of centrals, that their liquidity is of great importance for the whole of the credit union movement. OCCS, being subject to the provisions of the Co-operative Credit Societies Act, is required to maintain overall liquidity of 20% of deposits.[9] Leagues in Ontario, on the other hand, being subject to The Credit Unions Act, are subject to no mandatory overall liquidity requirement. While the managers of leagues are undoubtedly aware of the necessity for maintaining some degree of liquidity and undoubtedly do so, the Committee is of the view that the Act should also contain a mandatory liquidity requirement for leagues in the operation of their centrals. The Committee recommends that leagues be subject to the same liquidity requirements as the individual

credit unions. This represents a lower liquidity ratio than that imposed on OCCS, but the Committee is again conscious of the problem of finding a balance which will afford a reasonable measure of protection to those credit unions which use the facilities of a league central and at the same time not divert an excessive percentage of assets into areas outside the credit union movement.

13. It has been represented to the Committee that credit unions should be allowed to rely on bank lines of credit to meet liquidity needs or alternatively that bank lines of credit should be considered as part of the "assets" of a credit union which constitute cash or near cash for liquidity purposes. Some support for this may be found in the provisions of The Loan and Trust Corporations Act which allows bank lines of credit to be taken into account, subject to such terms and conditions as the Registrar imposes. The Committee has been advised however that bank lines of credit will not be considered as meeting liquidity in the case of trust companies or loan companies which accept deposits. Bank lines are only permitted to satisfy liquidity requirements in the case of loan companies which do not accept deposits and which have an irrevocable line of credit, established by a written undertaking from a bank, for at least one year. The provision in The Loan and Trust Corporations Act was designed to cover the peculiar position of those loan companies which do not accept deposits but borrow in the long term capital markets. In the opinion of the Committee, bank lines of credit, as such, being subject to fluctuation at the instance of a bank, should not be regarded as the equivalent of cash to meet liquidity requirements of the credit union movement.

14. The question of liquidity cannot be divorced from management. Competent management of a credit union should recognize the need for liquidity and make a reasonable effort to forecast the cash needs of the credit union to meet anticipated withdrawals. Under certain circumstances, this could result in a credit union maintaining a higher percentage of liquid assets than the minimum percentages recommended by the Committee. What is recommended by the Committee appears to be a minimum acceptable percentage under most circumstances and should not be considered as a substitute for good management if a higher percentage of liquid assets may be needed or desirable in a credit union at any particular time to meet abnormal situations which may arise from time to time.

15. The Committee recommends that:

(a) each credit union and league central be required to maintain in cash or in the investments described below, 10% of the total of its deposits (including term or time deposits but excluding deposits subject to withdrawal by negotiable order), shares and borrowings;

(b) each credit union and league central be required to maintain in cash or in the investments described below, 20% of the total of its deposits subject to withdrawal by negotiable order;

(c) since the aforesaid percentages are in the opinion of the Committee minimum acceptable percentages at the present time, the Act provide for the increase in the aforesaid percentages by Regulation so that the liquidity percentage may be adjusted quickly, if this should prove necessary or desirable, in view of the probable emerging pattern of credit unions which may result if the recommendations of this Committee with respect to the membership bond are implemented;

(d) the liquidity requirement be represented by

(i) cash on hand or on deposit with a bank, loan or trust company, the Province of Ontario Savings Office, a league central or OCCS,

(ii) investments in shares of a league, and bonds, debentures or other obligations of or guaranteed by the Government of Canada or of or guaranteed by any province thereof, excluding any such investments that are pledged as security for money borrowed by the credit union;

(e) of the total liquidity requirement, at least 10% be represented by cash and deposits of the type referred to in clause (d) (i) above;

(f) investments for the purposes of determining the percentage of liquidity maintained be valued at market rather than at face amount as section 27a (2) (b) of the Act now provides; and

(g) a credit union and a league central be prohibited from making any loan or any investment (other than investments of the class referred to in clause (d) (ii)) at any time when its liquidity is less than the minimum percentages.

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1. The Loan and Trust Corporations Act, R.S.O. 1960, c.222, section 84; as re-enacted 1966, c.81, section 7 and amended 1968, c.66, section 4.
2. S.C. 1966-67, c.87, section 72.
3. Alberta Standard By-laws, article XII, section 6.
4. New Brunswick Standard By-laws, article XII, section 3.
5. Newfoundland Co-operative Societies Rules, Rule 37.
6. Saskatchewan Act, sections 65 and 87.
7. Manitoba Act, section 57A.
8. British Columbia Act, section 34.
9. Co-operative Credit Associations Act, S.C. 1953, c.28, sections 44 and 45, as amended 1968-69, c.31, section 6.

CHAPTER 25

Financial Stability

Stabilization Fund

1. In addition to the internal reserve or guarantee fund of the local credit union, a number of the other provinces require all credit unions to contribute to a common fund which is variously called a stabilization fund, a mutual aid fund or a provincial share and deposit guarantee fund. The purpose of such a fund is to provide an additional measure of protection to members of the credit union movement by requiring each credit union to contribute a certain amount which is then available throughout the whole of the movement in the province. If a credit union were to experience an abnormal loss on loans or because of other factors, such as misfeasance, its internal reserve fund probably would not be large enough to absorb the loss and members' share and deposit accounts would be impaired. A stabilization or mutual aid fund would then operate to protect the members against loss. Such a fund is in effect a form of insurance financed by and in most cases administered by the credit union movement. In some provinces, the fund can be used for purposes other than to meet losses which members may suffer.

2. There is in Ontario no mandatory fund of this nature. OCUL, recognizing the value of a stabilization fund, established a voluntary fund in 1961. Each credit union that is a member of OCUL and chooses to participate in the fund initially invests an amount equal to 1/10 of 1% of its shares and deposits by way of a non-interest bearing loan repayable at the end of 15 years. Each year thereafter, the participating credit union adds to the amount originally loaned an amount equal to 1/10 of 1% of any increase in shares and deposits over the previous year. OCUL in its brief has advised the Committee that all but 11 of its member credit unions participate in the fund, which is a clear recognition by a large part of the movement of the need for such a fund. The size of the fund at July 31, 1969 was approximately $675,000. This fund has been used to render assistance to credit unions which have found it necessary to wind up operations and to make outright grants to those in financial difficulties. In the case of the winding up of a credit union, the fund has been used to purchase the assets, thus permitting an immediate payment to members of the amount of their shares and deposits, which might otherwise be delayed pending the collection of members' loans. The fund then takes over the collection of the loans. The Committee is advised that, since 1961 and to the end of 1968, some 80 credit unions have been wound up under this plan, with the membership in each case receiving 100 cents on the dollar, and 8 outright grants have been made, presumably to credit unions in some kind of financial distress.

3. OCUL has made a valuable contribution to the stability of the credit union movement by the institution of its voluntary fund. However, there are several areas which limit the effectiveness of the fund. Firstly, not all credit unions in the province contribute to it. In addition to the small number of members of the league who have chosen not to participate, there some 116 credit unions who are not eligible to participate either because they are members of other leagues or not members of any league. Secondly, the size of the fund appears to the Committee not to be adequate. While the fund has been able to meet the demands on it since its inception, it is questionable how much assistance it could render if a major credit union were to experience financial difficulties. Although there is provision in the resolution of OCUL establishing the fund whereby contributions could be increased, OCUL, because of the voluntary nature of the fund, would, in our opinion, have difficulty in convincing members to increase their contributions to meet a serious financial crisis. A third disadvantage is the fact that not all credit unions in the province are covered and, if a credit union, not a participant in the fund, experienced financial difficulties, there would not only be hardship to its members, but to the movement as a whole.

4. OCUL in its brief to this Committee has recommended that membership in a stabilization fund be made compulsory for all credit unions. A similar submission has been made by two local credit unions submitting briefs. The Committee is of the opinion that participation by all credit unions in a stabilization fund should be made mandatory. Such mandatory participation is required in most of the other provinces[1].

5. There appears to be no consistency in the legislation of those provinces where mandatory participation in a stabilization fund is required as to the uses to which the fund may be put. In certain provinces, the fund may be utilized on a broader basis than in others. In Saskatchewan, the fund, in addition to its primary use to protect members against loss, may also be used to provide financial assistance to credit unions in financial difficulties, presumably in the hope of rehabilitating such credit unions without loss to members.[2] In British Columbia, the fund would appear to be available only if a credit union fails, neglects or refuses to redeem a member's shares or to pay to the member his deposits.[3] The Committee feels that, while the primary purpose of the fund should be as a protection to members against loss, the fund can and should be used for the broader purposes of providing financial assistance, either in the form of loans or grants to credit unions in financial difficulties with a view to their rehabilitation, and of assisting and expediting in the orderly winding up of credit unions. The present voluntary fund of OCUL has been used in these ways with success and the right to use the mandatory stabilization fund in the same manner should be continued.

6. The Committee is concerned that the size of the present voluntary fund is not adequate in the event that a major credit union should find itself in financial difficulties or if more than one of the smaller credit unions experienced difficulties at about the same time. It is difficult to determine a proper level for the size of the fund consistent with providing an adequate protection to all members of the movement and at the same time not building the fund to an unrealistic level. Originally, in British Columbia, the Credit Union Reserve Board was authorized to assess upon all credit unions such sum as the Board determined not exceeding 1/5 of 1% of the total of each credit union's share capital and deposits until the amount of the fund equalled 1%, or such lesser percentage as the Board determined, of the total share capital and deposits of all credit unions.[4] In 1968 the Act was amended to provide, in effect, for an increase in contributions to a maximum of ½ of 1% of each credit union's net share capital and deposits and for contributions to continue until the contributions of each credit union equal 2% of its net share capital and deposits.[5] The Committee understands that the fund in British Columbia now totals about $4,000,000. In Saskatchewan, credit unions are required to contribute to a mutual aid fund 5% of yearly net earnings until the fund reaches at least 1% of the total of the share capital and deposits of all credit unions.[6] Including the assessment made for the current year, the fund in Saskatchewan will have reached approximately $4,000,000, about 1% of the total of the share capital and deposits of all credit unions in the Province. It has been indicated to the Committee that the Mutual Aid Board in Saskatchewan may recommend the 1% ceiling be eliminated. In New Brunswick, contributions continue until the fund has reached 1% of the total of the share capital and deposits of all credit unions.[7] The Alberta Act appears to be silent on the maximum size of the fund but it is understood that the fund in this province is now about $1,000,000. The proposed Manitoba Act would base contributions on a percentage, not to exceed ¼ of 1%, of loans outstanding until the fund reaches 1% of the total of all loans of all credit unions when provision is made for a revolving of contributions on a first in, first out basis. It would appear that in most of the provinces where there is now a mandatory fund the minimum size of the fund is not less than 1% of the total of the share capital and deposits of all credit unions in the province. The Committee feels that a mandatory fund in Ontario should not be of any less size.

7. In British Columbia, Saskatchewan, Alberta, Manitoba and New Brunswick, the particular fund is administered by a separate board created under the relevant legislation. In Manitoba and New Brunswick there are two funds and two boards which recognize the separate existence of credit unions and caisses populaires in those provinces. In each province the composition of the board administering the fund is such that a majority of the members comprising the board are representatives of the credit union

movement and, except in New Brunswick, the provincial authority responsible for credit unions is represented on the board. In some provinces,[8] payments from the fund may only be made with the approval of the provincial authority, thus giving government a veto on expenditures. OCUL, in its brief to the Committee, has suggested that a mandatory stabilization fund should not be government administered but that in effect there should be a fund in each league, administered by the league and presumably with each credit union in a particular league contributing to the fund administered by its league. Such a fragmentation of a stabilization fund into separate funds administered by each of the leagues might well serve to defeat the purpose of the fund. OCUL is by far the largest league in Ontario and the other leagues are quite small by comparison. A fund administered by the other leagues for the benefit of their members might very well be too small to meet the purposes for which it is established. One must also consider the position of the credit unions in the province that are not members of any league in view of the recommendation of the Committee that membership in a league not be made compulsory. To which fund would they contribute? The Committee is of the view that the requirements for the administration of a mandatory stabilization fund in Ontario can best be met by the creation of a separate Stabilization Board. Recognizing that the fund represents credit union moneys and that the credit union movement should play a large part in the administration of the fund, a majority of the members of such a Stabilization Board should be credit union representatives.

8. As an alternative to a mandatory stabilization fund, the Committee considered the possibility of some form of share and deposit insurance. At the present time, credit unions are not eligible to participate in the deposit insurance provided by the Canada Deposit Insurance Corporation and, if there were to be a system of share and deposit insurance available to credit unions, it would have to be provincially operated until at least such time as credit unions were permitted to participate in the federal plan. A provincially operated plan of share and deposit insurance, which would in effect be open only to credit unions, would undoubtedly be an expensive proposition, not only for government but for the movement. Moreover, such insurance could only operate after a loss had been incurred whereas a stabilization fund can be used for broader purposes. Deposit insurance, of necessity, would remove administration from the movement into Government and this we consider undesirable. The Committee feels that a mandatory stabilization fund is a more acceptable solution to the problem. It may be, if credit unions are ultimately permitted to participate in the federal plan, that the movement will consider this the desirable course to follow. This is a matter for the future on which the Committee, at this time, would not want to express opinion. Under the present circumstances, the Committee views a mandatory stabilization fund as the preferable route to follow. In

this connection, the Committee agrees with the views expressed by the Royal Commission on Banking and Finance "we believe it desirable in the movement's own interest that the primary source of insurance come from within its own ranks".[9]

9. The Committee recommends that:

(a) all credit unions in the province be required to contribute to a stabilization fund;

(b) the stabilization fund be paid to and administered by a Stabilization Board to be created by the legislation and to be composed of seven members to be appointed by the Lieutenant Governor in Council, of which four should be representatives of the credit union movement, one shall be the Director and two should be representatives of the public generally not connected with the credit union movement;

(c) the Stabilization Board should be given wide powers in the administration of the fund, including the power to borrow moneys and to appoint an administrator of credit unions that seek assistance from the fund;

(d) the Director should not have a veto over expenditures from the fund;

(e) the fund should be available not only to meet losses of members of their share capital and deposits but also for the purposes of providing financial assistance to a credit union which may be experiencing financial difficulties and assisting in the orderly liquidation of credit unions;

(f) each credit union be required to contribute annually to the fund 1/10 of 1% of the total of its share capital and deposits until the contributions of such credit union reach 1% of the total of the share capital and deposits of such credit union and thereafter 1% of any increase in its share capital and deposits:

(g) if the capital of the stabilization fund is reduced as a result of its use for the purposes set out in clause (e), each credit union shall contribute, in addition to the contributions under clause (f), 1/10 of 1% of its shares and deposits annually until the fund has been restored;

(h) the Stabilization Board be given power to assess an extraordinary levy for the purposes of the fund if this should be required; and

(i) pending its utilization, the stabilization fund be maintained in bank deposits, deposits with loan or trust companies, deposits with the Province of Ontario Savings Office, deposits with OCCS or the central of a league or invested in investments which constitute "eligible" investments for insurance companies under the provisions of The Corporations Act.

1. Alberta, British Columbia, Manitoba, New Brunswick, Prince Edward Island, Saskatchewan.
2. Saskatchewan Act, section 123.
3. British Columbia Act, section 94.
4. Ibid. section 97.
5. An Act to amend the Credit Unions Act, S.B.C. 1968, c.13, section 17.
6. Saskatchewan Act, section 118.
7. New Brunswick Act, section 42J.
8. Saskatchewan and New Brunswick.
9. Report of The Royal Commission on Banking and Finance, page 170.

CHAPTER 26

Financial Stability

Supervision

1. External supervision of credit unions is another important factor in ensuring the stability of credit unions and the protection of members' shares and deposits. All provincial legislation provides for some form of external supervision, in most cases by the provincial authority, and in some provinces provision is made for a mandatory yearly inspection.[1] In Ontario external supervision at the present time is a split function between the Department and the leagues.

Section 50(3) of the Act provides:

> "(3) The supervisor or any person authorized by the Director may inspect and examine into the conditions and affairs of any credit union and shall be given access to all books, records and other documents and may make such inquiries as are necessary to ascertain its condition and ability to provide for the payment of its liabilities as they become due, and whether or not it has complied with this Act, and the officers and employees shall facilitate such inspection and examination."

The section is permissive, rather than mandatory, and there is no obligation on the Department to make an examination on a regular basis or at all.

Section 53(7) and 53(8) of the Act provide:

> "(7) Any competent person authorized by a league incorporated under this section may examine into the affairs of any credit union that is a member of the league and for such purpose he shall be given access to all books, records and other documents of the credit union and he may make whatever inquiries are necessary to ascertain its true condition and its ability to provide for the payment of its liabilities as they become due, and the officers and employees of the credit union shall facilitate him in his examination and inquiry.
>
> (8) Where, as a result of an examination under subsection 7, it appears that the assets of the credit union are shown in the statement mentioned in section 49 or in its records at an amount greater than their true value or that its records are inadequate to show its true financial position, or that it is being managed improperly, the league shall immediately report such information to the supervisor, and the league shall upon the request of the supervisor furnish him with such information as he requires regarding or resulting from the examination."

2. Under the authority of sections 50(3) and 53(7) examinations are carried out by both the Department and the leagues. At present, most credit

unions are examined by Departmental examiners about once every two years. The Department endeavours to subject credit unions with a history of deficiencies or bad management to more frequent examination and some credit unions which are considered by the Department as financially sound and well managed may be examined at intervals of more than two years, particularly if they have appointed an auditor and are members of a league. The Department presently employs seventeen examiners who are primarily responsible for the external supervision of over 1,600 credit unions. Such a small staff cannot be expected to examine every credit union in Ontario in depth and on an annual basis and the Department relies heavily on the regular examinations carried out by examiners employed by the leagues, particularly OCUL. OCUL carries out regular examinations of its members and employs twenty-six full-time examiners. La Fédération des Caisses Populaires (C.F.) de L'Ontario Ltée. has three full time examiners and La Caisse Régionale Nipissing et Sudbury Ltée., one; but the membership of such leagues is much smaller than the membership of OCUL.

3. The practice seems to have grown up between the Department and OCUL for the Department to examine a member credit union in one year and OCUL in another so that most members of OCUL are examined every year. This arrangement depends for its effectiveness on a great deal of co-operation and liaison between the Department and OCUL. OCUL, as a matter of practice, sends a copy of all its examination reports to the Department and if any of the conditions referred to in Section 53(8) are discovered during the course of its examination, the report submitted to the Department is green stamped as a form of immediate alert. The other two leagues do not send a copy of all examinations to the Department but only those which are required to be brought to the attention of the Department under section 53(8). As a result, the Department is not aware of the examinations made by these leagues or the scope of them and accordingly attempts to examine the members of such leagues on a more frequent basis.

4. The present system of external examination of credit unions appears to be unsatisfactory in several aspects. Firstly, the effectiveness of the present system whereby responsibility for the examination of credit unions is divided between the Department and the leagues is dependent upon close co-operation and co-ordination so as to avoid any unnecessary duplication or oversight in their respective examinations. However, the Committee has received submissions indicating that the degree of integration between the separate but interdependent examinations by the leagues and the Department to produce an efficient comprehensive examination system may not always exist. We are advised that some credit unions have not been examined either by a league or by the Department for periods up to five years, while other credit unions have been examined both by league examiners and by the Department in a single year for no apparent reason other than lack of communication. Secondly, although the Act gives the Department

the right to examine a credit union at any time, it does not impose an obligation on the Department to examine. Some provincial Acts require the official responsible for supervising credit unions to examine each credit union "once in twelve months"[2] or "at least annually".[3] The Royal Commission on Banking and Finance in its chapter on credit unions and caisses populaires recommended that all credit unions should be subject to examination "at least once a year and more often if necessary".[4] The regular annual examination is perhaps the most important single means of ensuring individual credit unions are operating in accordance with the Act and are on a sound financial basis and is therefore important in assuring the stability of the credit union movement as a whole. The Committee therefore considers inadequate the present provisions of the Act relating to the examination of credit unions and the current practice whereby most credit unions are subject to examination by the Department biennially, some annually and a number only at infrequent and irregular intervals.

5. The Committee recognizes that with over 1,600 active credit unions in Ontario, a requirement to examine every credit union on an annual basis would place a considerable administrative burden upon those responsible for the supervision of credit unions. The credit union movement in those provinces where the relevant legislation requires annual examinations is far smaller than that in Ontario and a fewer number of annual examinations is required. Nevertheless, we consider the annual examination of all credit unions to be essential and are therefore principally concerned as to how such examination may best be carried out.

6. Apart from evidence of the lack of co-ordination between the leagues and the Department in the examination of credit unions, the Committee considers that the present de facto partial delegation of responsibility for the regular examination of credit unions to the leagues to be unsatisfactory in principle. The present system as OCUL suggested in its brief results in considerable and unnecessary overlapping and duplication of work and confusion to credit unions from different viewpoints being superimposed on them by two groups of examiners. The examination is not an audit and, among other things, examiners advise credit unions on the suitability of their systems. As OCUL has pointed out "each body of examiners over the years has developed its own approach to a multitude of problems and advise credit unions accordingly. The existence of two such bodies has hindered any standardized approach to particular problems throughout the movement and has confused the membership." It appeared to the Committee that the only satisfactory means of creating an efficient comprehensive system for the regular examination of credit unions is to vest in one body sole responsibility for the conduct of such examinations. In no other province, save perhaps Quebec, where the legal position is not clear, is the responsibility for the regular examination of credit unions shared between two separate and independent bodies.

7. The Committee considered whether the Department should be made wholly responsible for the annual examination of credit unions, leaving the leagues with their present power under section 53(7) of the Act to examine the affairs of their member credit unions but not as part of the regular examination process. However, there appear to be two objections to such a proposal. Firstly, the Department already bears the entire financial cost of maintaining seventeen examiners since, in contrast with certain other provinces, no charge is levied upon credit unions for the examination by the Department. To require annual examinations of all credit unions by the Department would necessitate a considerable increase in the number of examiners employed by the Department and consequently a significant rise in the costs of the Department in administering the Act. At least two provincial Acts impose a scale of charges for annual examinations of credit unions[5] and we are advised that the provincial authorities in those provinces are thereby able to recover much of the cost of maintaining an examination service. The Committee considers that the credit union movement should be financially responsible for the cost of maintaining an adequate examination service. Nevertheless, we do not recommend that the Department be vested with sole responsibility for the annual inspection of credit unions and recoup the additional expense by charging a fee for examinations since to do so would eliminate the existing limited degree of self-regulation which presently exists through the participation of the leagues in the examination process.

8. The Committee is of the view that self-regulation in the credit union movement with regard to the responsibility for conducting the annual examination should be encouraged. OCUL has on various occasions proposed that the present system be rationalized by the exclusive delegation to the leagues of the responsibility for periodic examination of credit unions and a recommendation to that effect is contained in their brief to this Committee. What is envisaged by the proposal is that the regular periodic examination of credit unions would be conducted solely by the leagues while government inspectors would be concerned only with special investigations of particular credit unions usually prompted by the green stamped reports of the leagues submitted to the Department. To entrust to the leagues the sole responsibility for conducting annual examinations of credit unions would no doubt produce the self-regulation which we agree is desirable in principle. There is, however, one major objection to vesting this function in the leagues. It has been noted in Chapter 2 that some 34 credit unions in Ontario representing total assets of about $48,000,000 have elected not to join any league and this Committee recommended against making membership in a league compulsory. This raises the question how would such credit unions be examined on a regular basis without again splitting the function? The Committee considered as a possible alternative to compulsory membership in a league a requirement that those credit

unions not members of a league should designate which league would examine their affairs. However, the Committee concluded that since this would of necessity involve a requirement that unaffiliated credit unions contribute through inspection fees (which in the case of members are paid out of membership dues) to a league which they have chosen not to join, it would be in conflict with out main recommendation that credit unions be free to join or not to join a league as they see fit. The Committee recommends that the responsibility for conducting annual examinations not be vested in the leagues.

9. The Committee recommended in Chapter 25 the establishment of a compulsory stabilization fund to be administered by a Stabilization Board consisting of four representatives of the credit union movement, two persons unconnected with the credit union movement and the Director. It would appear to the Committee for several reasons that the Stabilization Board is the appropriate body in which to vest responsibility for the annual examination of credit unions. Firstly, it would provide a means whereby annual examination could be made the primary responsibility of the credit union movement rather than the Department, which in principle is what we recommend, without impinging upon the freedom of those credit unions which choose not to join a league. Secondly, while enabling the credit union movement to be self-regulating so far as the conduct of annual examinations is concerned, since we recommended that a majority of the Stabilization Board should consist of representatives of the credit union movement, it would at the same time not entirely exclude the participation in a minority role of the government through the membership of the Director. Even if the immediate responsibility for examining credit unions is removed from the Department, the ultimate responsibility for the financial stability of the credit union movement inevitably rests with the provincial authority. Thirdly, and perhaps most important, the Committee considers that the responsibility of examining credit unions annually is a natural adjunct of the basic function of the Stabilization Board which is to preserve the financial stability of credit unions by ensuring that no credit union member suffers a loss as a result of the insolvency or illiquidity of any credit union. Since the practical use of the stabilization fund is to make good losses incurred by credit unions it would seem to the Committee that the Stabilization Board, not unlike an insurer, has a primary and pecuniary interest in regularly surveilling the financial position of individual credit unions which is essentially the purpose of the annual examination. This would draw to the attention of the Stabilization Board at the earliest possible moment any financial weakness or unsound policies of a credit union which if left unchecked might result in claims being made against the stabilization fund.

10. The Committee considers that if the credit union movement is, in effect, to be self-regulating so far as the annual examination of credit unions

is concerned it should also be self-supporting. The Committee recommends that the cost of maintaining a sufficient staff of examiners to examine every credit union in Ontario on an annual basis should be met, as far as possible, from the income of the stabilization fund. However, we recognize that it will be some years before the stabilization fund will have reached an amount which would produce sufficient income to cover the costs of administrating an annual examination system. Until the fund has attained sufficient size, the Committee recommends that credit unions be charged an annual examination fee assessed according to their assets to the extent that the income of the fund is insufficient. In the first years of the stabilization fund when its income will be at its lowest, the Committee also recommends that consideration be given to the provision of a grant to the Stabilization Board by the government by way of contribution to the cost of examination.

11. The Stabilization Board should furnish a copy of each examination to the Department and the Department should retain a staff of examiners to investigate those credit unions which are not being operated satisfactorily. The Committee does not consider that there should be any change in or lessening of the powers of the Director under section 51.

12. The Committee recommends that:

(a) the Stabilization Board be required to carry out an annual examination of all credit unions;

(b) the cost of such annual inspection be defrayed, to the fullest extent possible, from the income of the stabilization fund, with any deficiency to be met by an assessment against all credit unions, based on size of assets;

(c) in the early years of the Stabilization Board and until the stabilization fund is built to its desired size, the province consider a subsidy toward the cost of the annual examination;

(d) a copy of each examination made by the Stabilization Board be furnished to the Department; and

(e) there be no change in the powers of the Director under section 51.

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1. Alberta Act, section 67.
   British Columbia Act, section 42.
   Manitoba Act, section 80.
   Prince Edward Island Act, section 28.
   Saskatchewan Act, section 99.
2. Manitoba Act, section 80.
3. Prince Edward Island Act, section 28.
   Saskatchewan Act, section 99.
4. Report of The Royal Commission on Banking and Finance, page 169.
5. B.C. Reg. 7/65 as amended by Regulation 20/65.
   Saskatchewan Regulation 282/68.

CHAPTER 27

Financial Stability

Auditors

1. In the traditional tripartite division of the administration of the affairs of a credit union the responsibility for examining and auditing the books of a credit union is vested in the supervisory committee.

2. A voluntary supervisory committee may be capable of maintaining adequate supervision over the financial affairs of a small credit union, but as the membership and assets of a credit union grow the duties of the supervisory committee become increasingly complex and onerous with the result that it may be difficult to find, among the members of larger credit unions, persons who are able and willing to serve on a voluntary basis on the supervisory committee. Even if such members are available it may not always be desirable for a supervisory committee whose members lack professional training to undertake alone the responsibilities of auditing the books and examining the financial affairs of a credit union since they cannot be expected to act with the same degree of competence and thoroughness as an experienced, qualified outside auditor. The leagues, as part of an educational service, provide handbooks and advice and valuable assistance to the voluntary supervisory committee, but this cannot, of itself, ensure any degree of expertise.

3. The desirability, and perhaps in some cases the necessity, of a credit union obtaining the assistance of a professional outside auditor is reflected in several provisions of the Act. A credit union may by by-law appoint an auditor in addition to or in lieu of the supervisory committee and may delegate to such auditor the whole or such part of the duties of the supervisory committee as the by-law provides.[1] The supervisory committee has power to appoint an auditor with the prior written approval of the supervisor if the majority of the supervisory committee suspects that any of the funds, securities or other property of the credit union have been "misappropriated or misdirected".[2] The supervisory committee may also have a general power to appoint an auditor pursuant to section 32(14) of the Act as a "person" to assist it in performing its duties although, since the remuneration of such a person is subject to determination by the board of directors, as a practical matter this power may be severely limited. Since there is some question as to the scope and meaning of the particular provision, the Committee elsewhere recommended amendments to the relevant provision of the Act to vest in the supervisory committee a general independent power to appoint an auditor to assist it and to authorize his remuneration.

4. In certain circumstances a credit union may have an auditor imposed upon it. Under section 51 of the Act the Director may appoint an auditor to examine the affairs of a credit union "where it appears to the Director from an examination of the condition and affairs of a credit union that any of the funds, securities or other property of the credit union may have been misappropriated or misdirected or that the records do not show the true financial position of the credit union". This power arises only after it has come to the notice of the Director that a credit union may be in difficulties and, as in the case of the power of the supervisory committee to appoint an auditor with the written consent of the supervisor, losses may have already occurred and it may be too late for the auditor to do more than perform a post mortem.

5. The Act requires a credit union to appoint an auditor only when it wishes to permit its members to withdraw deposits by means of negotiable orders (i.e. chequing facilities). Section 27a of the Act, which came into force in 1964, permits under conditions prescribed therein, credit unions with a combined share capital and deposits of more than $100,000 to permit members to withdraw deposits by means of negotiable order. One of the conditions requires such credit unions to appoint an auditor either in addition to, or in lieu of, the supervisory committee. A likely reason for the requirement that such credit unions appoint an external auditor is that for the first time the general public are expected to place their trust in a credit union by accepting cheques drawn on it. Chequing facilities in credit unions are a fairly recent innovation in Ontario and we are advised that at present only about 83 credit unions and 53 caisses populaires offer this service, although many more are of sufficient size to qualify. If the experience of other provinces is a valid guide, chequing will probably become a standard service offered by most credit unions which qualify under section 27a of the Act. For commercial reasons, a credit union may have to introduce a chequing service and will thereby be compelled to appoint an auditor, but until it does so it is not compelled to appoint an auditor and if it chooses not to provide a chequing service it may never have to appoint an auditor under the present requirements of the Act.

6. It is perhaps anomalous that all commercial corporations of whatever size are required by The Corporations Act to appoint auditors, while a credit union, an institution dealing almost exclusively in money, is required to appoint an auditor only in the limited event that it chooses and is eligible to permit its members to withdraw deposits by negotiable orders. Although The Corporations Act does not state that an auditor need have any special qualifications, the Committee, in its earlier Interim Report,[3] noted that no amendment to that Act was required since the provision of the Public Accountancy Act would effectively preclude anyone from performing the statutory duties of an auditor without being licensed under that Act.

7. There is an increasing trend in other provinces towards making the appointment of a qualified external auditor mandatory by credit unions which have attained a certain size in assets. There is some variation in the size a credit union may reach before it is required to appoint an auditor. In Nova Scotia and Prince Edward Island, credit unions with total assets and, in the case of Saskatchewan, with combined shares and deposits, exceeding $200,000 must appoint a qualified auditor.[4] In Alberta, a credit union with combined shares and deposits of more than $250,000 is required to appoint an external auditor.[5] A recent Rule promulgated pursuant to the provisions of the British Columbia Act requires credit unions in British Columbia with combined shares and deposits of more than $300,000 to appoint an auditor.[6] Those caisses populaires which do not belong to a recognized federation are required by the Quebec Act to appoint an auditor.[7]

8. The Committee is of the view that it is desirable in principle that all credit unions appoint an independent external auditor. This principle, must be tempered to a certain extent by a practical consideration of the cost involved. Credit unions under the Act are effectively limited in the total income they can generate by the interest ceiling on loans. There are many credit unions with closely knit memberships and an established record of good management which have assets of less than $100,000 and where financial hardship could result through a mandatory provision requiring the appointment of an auditor, particularly if account is taken of our earlier recommendation that all credit unions be required to contribute to a stabilization fund, which imposes an additional charge upon the income of credit unions, the recommendation that the amount of the annual appropriation to the guarantee fund be determined by reference to the outstanding delinquent loans of a credit union, which depending upon the management of the credit union, may result in a higher annual charge against income, and the recommendation of a minimum liquidity requirement which may have the effect of reducing the earning power of a credit union if it entails a reduction in the assets available for loans to members. These recommendations, together with our recommendation that all credit unions be examined at least once a year, are designed to promote and safeguard the stability of credit unions and, therefore, to protect the savings of members and while they do not, in the view of the Committee, affect the desirability in principle of a requirement that all credit unions appoint external auditors, they do justify the gradual implementation of such a requirement in the case of smaller credit unions. These overall recommendations also justify provision for the exemption of small credit unions from the requirement, if they can establish to the satisfaction of the Stabilization Board that they are sufficiently well managed so as not to require the appointment of an auditor in order to protect the savings of members and that because of their size and the inherent limitation upon their earning

capacity resulting from the interest ceiling, the expense of appointing an auditor would constitute a disproportionate charge on their income. A gradual implementation of the obligation to appoint an auditor will, it is hoped, enable smaller credit unions to adjust their operations to meet the increased expense of appointing an auditor.

9. Where a credit union, pursuant to our recommendations, is required to appoint an auditor such appointment should be made by the credit union at the annual meeting and the auditor so appointed should hold office until the next annual meeting or until his successor is appointed by the credit union in general meeting. The Committee also recommends that a credit union in general meeting be empowered by ordinary resolution to remove the auditor before the expiration of his term of office subject to such procedural requirements as may be needed to ensure adequate notice to the auditor so as to afford him an opportunity to make representations to the membership with respect to the proposed resolution for his removal and replacement. The Committee considers that the enactment of a section similar to section 155 of the proposed Business Corporations Act[8] which incorporates the recommendations of this Committee in its first Interim Report,[9] would provide a suitable framework for the appointment, tenure and conditions for the removal of an auditor of a credit union.

10. In order that the requirement for the appointment of an independent qualified auditor should constitute an effective check upon the financial affairs of a credit union and complement the annual examination of every credit union which the Committee earlier recommended be carried out by examiners appointed by and responsible to the Stabilization Board, the Committee considers it essential that the Act set out in detail the rights and duties of the auditor. Provisions substantially similar to those contained in subsections (1), (2), (5), (6), (8), (9) and (10) of section 158 of the proposed Business Corporations Act would appear to apply to the auditor of a credit union and, with necessary changes, should be embodied in the Act.

11. The Committee recommends that:

(a) all credit unions with combined shares and deposits exceeding $300,000 be required to appoint an auditor forthwith;

(b) that one year after such requirement is imposed for credit unions with combined shares and deposits exceeding $300,000, credit unions with combined shares and deposits exceeding $200,000 be required to appoint an auditor;

(c) that one year after such requirement is imposed for credit unions with combined shares and deposits exceeding $200,000, all remaining credit unions, subject as hereinafter provided, be required to appoint an auditor;

(d) a credit union with combined shares and deposits of less than $100,000 should have the right to apply to the Stabilization Board for permission to continue operating without appointing an auditor, which permission the Stabilization Board should be empowered to give, on a revocable basis, if it is established that the affairs of such credit union are sufficiently well managed so as not to require the appointment of an auditor in order to safeguard the savings of the members;

(e) the auditor be appointed by the members at the annual meeting;

(f) the members in general meeting be empowered by ordinary resolution to remove the auditor before the expiration of his term of office;

(g) a section similar to section 155 of the proposed Business Corporations Act be included in the Act to govern the appointment, tenure and conditions for the removal of the auditor of a credit union; and

(h) provisions substantially similar to those contained in subsections (1), (2), (5), (6), (8), (9) and (10) of section 158 of the proposed Business Corporations Act should be included in the Act to set out the rights and duties of the auditor of a credit union.

The foregoing recommendations are in addition to the present requirement that credit unions which permit their members to withdraw deposits by negotiable order appoint auditors. In the opinion of the Committee there should be no change in this requirement. Nor should these recommendations be construed as limiting or affecting the separate powers under the Act of the supervisory committee to appoint an auditor or the power of the Director to require the appointment of an auditor in the particular instances now provided in the Act.

1. Section 32(11).
2. Section 32(13).
3. Chapter X, Section 2.
4. Nova Scotia Act, section 40(2).
   Saskatchewan Standard By-laws, article 62.
   Prince Edward Island Act, section 19(5)(a).
5. Alberta Standard By-laws, article XIV.
6. B.C. Reg. 2/69.
7. Quebec Act, section 43 (e).
8. Bill 125, The Business Corporations Act, 1st Session, 28th Legislature, Ontario, 17 Elizabeth II, 1968.
9. Chapter X, Section 3.

CHAPTER 28

Miscellaneous Amendments

The Committee considered a number of miscellaneous, specific, isolated provisions in the Act which do not conveniently fit into the context of any of the previous chapters. Some are relatively minor and most were brought to the attention of the Committee in the submissions of OCUL.

1. *Transfers to "chequing accounts"*

The "chequing" service which certain credit unions are permitted to offer their members involves a deposit by the credit union in a current account with a chartered bank or OCCS. OCCS has special clearing facilities arranged with clearing houses. Cheques drawn by a member on his chequing account with the credit union are met from the current account of that credit union with the chartered bank or OCCS and the credit union in turn debits the member's chequing account by the amount of any negotiable order presented. In addition to a general prohibition against overdrafts,[1] presumably on the basis that an overdraft is in essence a loan and should therefore be subject to the precedures for the approval of loans contained in the Act and in the by-laws of a particular credit union, the Act specifically prohibits the use of general authorizations for the transfer of funds from a member's share or ordinary deposit account to his "chequing account". Under section 27b(2) such transfers require the express authorization of the member in writing given in each case. It was submitted to this Committee that to require written express authorization is an unreasonable condition since clearing house rules require that cheques which cannot be honoured by a credit union because of insufficient funds in the member's chequing account must be returned on the day of presentation and this does not always give the credit union sufficient opportunity to contact the member concerned and to obtain his express written authority for the transfer of funds to meet the cheque presented. Nor can a temporary overdraft be granted because of the prohibition against overdrafts in section 27b(1) referred to above. As a result a credit union may be compelled by law to return a cheque in circumstances where, were it not for the prohibition on a general authorization, the cheque could be honoured. The Committee is of the view that the prohibition against the use of general authorizations is an unnecessary inconvenience to both the credit union and its members and recommends that section 27b(2), which is exceptional among provincial Acts, be repealed.

2. *Bonding of Credit Union Officers and Employees*

The Act requires credit union officers or employees who receive or who have charge of moneys to be bonded in such manner and in such amount

as the board of directors determines before they may assume their duties.[2] The arrangements for the bonding of credit union employees are generally made by the leagues but it would appear that the powers of a league may not extend to arranging for the bonding of credit union officers.[3] OCUL in its submission to the Committee has suggested that the Act contain a provision stipulating the minimum coverage of the bond. In order to retain sufficient flexibility to meet changing conditions, the Committee considers that the requirements with respect to the bonding of credit union officers and employees be prescribed in Regulations to the Act and recommends that such Regulations should initially require every credit union to bond its officers and employees who receive and have charge of moneys in an amount at least equal to the total assets of the credit union subject to a maximum coverage of $1,000,000. The Committee is advised that this is the standard coverage currently available under the CUMIS 578 and CUNA 576 Bonds. The Committee also recommends that section 53(1)(c) be amended so as to remove any doubts as to the power of a league to arrange for group bonding of credit union officers as well as employees.

3. *Trust Accounts*

Unlike the legislation in several provinces, the Act contains no provision to protect a credit union from disputes involving the withdrawal of moneys subject to trusts. The Committee considers that a credit union should not have to concern itself with the terms of any trusts governing the beneficial ownership of shares or deposits and recommends the enactment of a provision similar to section 94(1) of The Loan and Trust Corporations Act which would limit the responsibilities of the credit union to dealing with and acting upon instructions of the registered holder of shares or deposits in the credit union.

4. *Investments and Deposits in a League*

The Act contains provisions respecting investments by a credit union in a league by way of deposits, loans or the purchase of shares. By way of incidental and ancillary powers a credit union may deposit money with and make loans to a league up to a maximum of 25% of its share capital and deposits.[4] A credit union is also empowered to invest in shares of a league amounts up to a maximum of 25% of its share capital.[5] Since there appears to be no immediate reason for the limitation on the purchase of shares in a credit union to 25% of its share capital rather than 25% of its share capital and deposits, as in the case of deposits in or loans to a league, the Committee recommends that a credit union be empowered to invest an amount not exceeding 25% of its share capital and deposits in the shares of a league. The effect of this recommendation would be to increase all forms of investment in a league to an amount not exceeding 50% of the shares and deposits of a credit union, but would still limit such maximum investment to 25%

in shares and 25% in deposits with or loans to a league. The Committee considers that a credit union should be permitted to select such form of investment in a league as it deems most advantageous and, therefore, recommends that the provisions of section 4(1)(b) and section 35(1)(c) be combined so as to permit a credit union to invest an amount not exceeding in the aggregate 50% of the shares and deposits of a credit union in a league whether by way of deposits, purchase of shares or loans.

5. *Organization expenses*

Section 28(3) requires that entrance fees and fines be added to the guarantee fund but permits the board of directors to withdraw up to $70 towards organization expenses incurred during the first year of operation. The amount which may be withdrawn has not been changed since the enactment of the provision in 1954. In accordance with a submission of the OCUL, the Committee recommends that the amount the board of directors should be permitted in their discretion to withdraw from the guarantee fund to be applied towards organization expenses incurred during the first year of operation be increased to $150.

6. *Items required to be included in the balance sheet*

Section 43(3) sets out the information which must be included in a balance sheet of a credit union. It appears to the Committee that there is additional information which should be included in the balance sheet which is not now required. The Committee recommends that section 43(3) be amended to require the balance sheet which must be placed before the members at the annual meeting to include, by way of additional requirements, a statement of the guarantee fund and other reserves, a statement of surplus, and a breakdown of investments.

1. Section 27b(1).
2. Section 34.
3. Section 53(1)(c).
4. Section 4(2)(b).
5. Section 35(1)(c).

Appendix A

Partial list of persons and organizations who submitted written briefs, communications or suggestions.

R. F. Bott.

Caledonia Community Credit Union Limited.

Canadian Westinghouse Employees' (Hamilton Works) Credit Union Limited.

College Heights (Guelph) Credit Union Limited.

Courtaulds Employees' (Cornwall) Credit Union Limited.

CUNA (Hamilton) Credit Union Limited.

Fort Erie E.S.C. Credit Union Limited.

Holy Name Parish (Kirkland Lake) Credit Union Limited.

L.C.B.O. Employees' (Toronto) Credit Union Limited.

Massey-Ferguson Employees' (Brantford) Credit Union Limited.

R. J. McMaster, Q.C., Vancouver.

Niagara Township Credit Union Limited.

Ontario Credit Union League Limited.

Ontario Department of Financial and Commercial Affairs.

Page-Hersey Employees' (Welland) Credit Union Limited.

Plymouth Cordage Credit Union Limited.

St. Andrews Parish (New Sudbury) Credit Union Limited.

St. Louis Parish (Waterloo) Credit Union Limited.

St. Michaels Parish (Leamington) Credit Union Limited.

B. B. Shekter, Q.C., Hamilton.